CARTERS INC
Form 10-Q
August 02, 2010

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 3, 2010 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	13-3912933
(state or other jurisdiction of incorporation or organization)	(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 (X) No ( )

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 (X) No ( )

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer, 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 July 30, 2010
Common stock, par value $0.01 per share	59,442,933

CARTER'S, INC.
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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	July 3, 2010	January 2, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 245,013	$ 335,041
Accounts receivable, net	99,526	82,094
Finished goods inventories, net	260,660	214,000
Prepaid expenses and other current assets	11,583	11,114
Deferred income taxes	25,726	33,419
Total current assets	642,508	675,668
Property, plant, and equipment, net	90,374	86,077
Tradenames	305,733	305,733
Goodwill	136,570	136,570
Deferred debt issuance costs, net	1,459	2,469
Licensing agreements, net	137	1,777
Other assets	292	305
Total assets	$ 1,177,073	$ 1,208,599
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 3,503	$ 3,503
Accounts payable	121,047	97,546
Other current liabilities	31,848	69,568
Total current liabilities	156,398	170,617
Long-term debt	229,269	331,020
Deferred income taxes	108,162	110,676
Other long-term liabilities	44,105	40,262
Total liabilities	537,934	652,575
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; par value $.01 per share; 100,000 shares authorized; none issued or outstanding at July 3, 2010 and January 2, 2010	--	--

Common stock, voting; par value $.01 per share; 150,000,000 shares authorized; 59,442,933 and 58,081,822 shares issued and outstanding at July 3, 2010 and January 2, 2010, respectively	594	581
Additional paid-in capital	256,048	235,330
Accumulated other comprehensive loss	(3,603)	(4,066)
Retained earnings	386,100	324,179
Total stockholders’ equity	639,139	556,024
Total liabilities and stockholders’ equity	$ 1,177,073	$ 1,208,599

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	For the three-month periods ended		For the six-month periods ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Net sales	$ 327,009	$ 326,329	$ 736,058	$ 683,491
Cost of goods sold	196,758	201,619	438,997	431,059
Gross profit	130,251	124,710	297,061	252,432
Selling, general, and administrative expenses	104,468	99,843	209,763	198,973
Workforce reduction and facility write-down and closure costs	--	2,980	--	11,400
Royalty income	(7,640)	(7,472)	(17,294)	(16,234)
Operating income	33,423	29,359	104,592	58,293
Interest expense, net	2,662	2,708	5,106	5,883
Income before income taxes	30,761	26,651	99,486	52,410
Provision for income taxes	11,665	10,017	37,565	19,172
Net income	$ 19,096	$ 16,634	$ 61,921	$ 33,238
Basic net income per common share (Note 13)	$ 0.32	$ 0.29	$ 1.05	$ 0.59
Diluted net income per common share (Note 13)	$ 0.32	$ 0.28	$ 1.03	$ 0.57

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 six-month periods ended July 3, 2010	July 4, 2009
Cash flows from operating activities:		
Net income	$ 61,921	$ 33,238
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,082	16,990
Amortization of debt issuance costs	1,010	567
Non-cash stock-based compensation expense	3,510	3,543
Income tax benefit from exercised stock options	(8,579)	(1,313)
Non-cash asset impairment and facility write-down charges	--	3,662
Gain on sale of property, plant, and equipment	(172)	--
Deferred income taxes	5,152	2,853
Effect of changes in operating assets and liabilities:		
Accounts receivable	(17,432)	401
Inventories	(46,660)	(52,665)
Prepaid expenses and other assets	(456)	(767)
Accounts payable and other liabilities	952	22,687
Net cash provided by operating activities	15,328	29,196
Cash flows from investing activities:		
Capital expenditures	(20,720)	(18,030)
Proceeds from sale of property, plant, and equipment	286	--
Net cash used in investing activities	(20,434)	(18,030)
Cash flows from financing activities:		
Payments on Term Loan (See Note 4)	(101,751)	(1,751)
Income tax benefit from exercised stock options	8,579	1,313
Proceeds from exercise of stock options	8,250	735
Net cash (used in) provided by financing activities	(84,922)	297

Net (decrease) increase in cash and cash equivalents	(90,028)	11,463
Cash and cash equivalents, beginning of period	335,041	162,349
Cash and cash equivalents, end of period	$ 245,013	$ 173,812

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 2, 2010	$581	$235,330	$ (4,066)	$324,179	$ 556,024
Exercise of stock options (1,221,003 shares)	12	8,238	--	--	8,250
Income tax benefit from exercised stock options	--	8,579	--	--	8,579
Restricted stock activity	1	(1)	--	--	--
Stock-based compensation expense	--	3,102	--	--	3,102
Issuance of common stock (24,032 shares)	--	800	--	--	800
Comprehensive income:					
Net income	--	--	--	61,921	61,921
Unrealized gain on interest rate swap agreements, net of tax of $272	--	--	463	--	463
Total comprehensive income	--	--	463	61,921	62,384
Balance at July 3, 2010	$594	$256,048	$ (3,603)	$386,100	$ 639,139

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 You (formerly Just One Year), Precious Firsts, OshKosh, 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 289 Carter's and 175 OshKosh retail stores that market our brand name merchandise and other licensed products manufactured by other companies.

NOTE 2 – BASIS OF PREPARATION:

The accompanying unaudited condensed consolidated financial statements include the accounts of Carter's, Inc. and its wholly owned 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 July 3, 2010, the results of our operations for the three and six-month periods ended July 3, 2010 and July 4, 2009, cash flows for the six-month periods ended July 3, 2010 and July 4, 2009 and changes in stockholders' equity for the six-month period ended July 3, 2010. Operating results for the three and six-month periods ended July 3, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending January 1, 2011. Our accompanying condensed consolidated balance sheet as of January 2, 2010 is from our audited consolidated financial statements included in our most recently filed Annual Report on Form 10-K, 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 ("SEC") 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 in the notes to our audited consolidated financial statements for the fiscal year ended January 2, 2010.

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 second quarter and first half of fiscal 2010 reflect our financial position as of July 3, 2010. The second quarter and first half of fiscal 2009 ended on July 4, 2009.

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

Subsequent events were evaluated and all appropriate disclosures are included within these financials.

NOTE 3 – COMPREHENSIVE INCOME:

Comprehensive income is summarized as follows:

	For the three-month periods ended		For the six-month periods ended	
	July 3,	July 4,	July 3,	July 4,
(dollars in thousands)	2010	2009	2010	2009

Net income	$	19,096	$	16,634	$	61,921	$	33,238
Unrealized gain (loss) on interest rate swap agreements, net of tax of $174, $85, and $272, and tax benefit of $2, respectively		297		144		463		(3)
Settlement of interest rate collar agreement, net of tax of $216		--		--		--		407
Total comprehensive income	$	19,393	$	16,778	$	62,384	$	33,642

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

NOTE 4 – LONG-TERM DEBT:

Long-term debt consisted of the following:

(dollars in thousands)	July 3, 2010	January 2, 2010
Term Loan	$ 232,772	$ 334,523
Current maturities	(3,503)	(3,503)
Total long-term debt	$ 229,269	$ 331,020

The Company's Senior Credit Facility is comprised of a $500 million term loan (the "Term Loan") and a $125 million revolving credit facility (the "Revolver") (including a sub-limit for letters of credit of $80 million). The Revolver expires on July 14, 2011 and the Term Loan expires July 14, 2012. There were no borrowings outstanding under the Revolver at July 3, 2010 and January 2, 2010, respectively. Principal borrowings under our Term Loan are due and payable in quarterly installments of $0.6 million through June 30, 2012 with the remaining balance of $227.9 million due on July 14, 2012.

Amounts borrowed under the Term Loan have an applicable rate of LIBOR + 1.50%, regardless of the Company's overall leverage level. Interest is payable at the end of interest rate reset periods, which vary in length but in no case exceed 12 months for LIBOR rate loans and quarterly for prime rate loans. The effective interest rates on Term Loan borrowings as of July 3, 2010 and January 2, 2010 were 1.8% and 1.7%, respectively.

During the second quarter of fiscal 2010, the Company prepaid approximately $100 million in Term Loan borrowings, or approximately 30% of its outstanding debt, in addition to a regularly scheduled amortization payment of approximately $0.9 million. In addition, the Company wrote-off $0.5 million of debt issuance costs related to the prepayment of a portion of our Term Loan debt.

NOTE 5 – GOODWILL AND OTHER INTANGIBLE ASSETS:

Goodwill as of July 3, 2010 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. Our goodwill is not deductible for tax purposes. Our Carter's goodwill and Carter's and OshKosh tradenames are deemed to have indefinite lives and are not being amortized.

The Company's intangible assets were as follows:

		July 3, 2010			January 2, 2010		
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount
Carter's goodwill (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	$ 18,963	$ 137	$ 19,100	$ 17,323	$ 1,777
Leasehold interests	4.1 years	$ 1,833	$ 1,833	$ --	$ 1,833	$ 1,833	$ --

(1) $51.8 million of which relates to Carter’s wholesale segment, $82.0 million 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 $0.8 million for the three-month period ended July 3, 2010 and $1.0 million for the three-month period ended July 4, 2009. Amortization expense for intangible assets was approximately $1.6 million and $2.0 million for the six-month periods ended July 3, 2010 and July 4, 2009. Amortization expense for the OshKosh licensing agreements is expected to be approximately $0.1 million for the remainder of fiscal 2010.

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

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 fiscal 2009, the Internal Revenue Service completed an income tax audit for fiscal 2006 and 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 half of fiscal 2009, we recognized approximately $1.0 million in tax benefits due to the completion of an Internal Revenue Service audit for fiscal 2006.

As of July 3, 2010, the Company had gross unrecognized tax benefits of approximately $8.5 million. Substantially all of the Company's reserve for unrecognized tax benefits as of July 3, 2010, 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.

Included in the reserves for unrecognized tax benefits as of July 3, 2010, 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. During the second quarter and first half of fiscal 2010, the Company recognized interest expense on uncertain tax positions of approximately $0.1 million and $0.2 million, respectively. During the second quarter of fiscal 2009, the Company recognized interest expense on uncertain tax positions of approximately $0.1 million. During the first half of fiscal 2009, the Company's recognized interest expense on uncertain tax positions was offset by a reduction in interest expense related to the successful resolution of the Internal Revenue Service audit for fiscal 2006. The Company had approximately $0.7 million and $0.6 million of interest accrued as of July 3, 2010 and January 2, 2010, respectively.

NOTE 7 – FAIR VALUE MEASUREMENTS:

The Company reports its fair value measurements in accordance with accounting guidance, which 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 1 - Quoted prices in active markets for identical assets or liabilities

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

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

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

(dollars in millions)	July 3, 2010 Level 1	July 3, 2010 Level 2	July 3, 2010 Level 3	January 2, 2010 Level 1	January 2, 2010 Level 2	January 2, 2010 Level 3
Assets						
Investments	$ --	$ 230.3	$ --	$ --	$ 130.0	$ --
Liabilities						
Interest rate swaps	$ --	$ 0.6	$ --	$ --	$ 1.3	$ --

At July 3, 2010, we had approximately $215.3 million invested in money market deposit accounts and $15.0 million invested in a Dreyfus Treasury Prime Cash Management fund, which invests only in U.S. Treasury Bills or U.S. Treasury Notes.

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

NOTE 7 – FAIR VALUE MEASUREMENTS: (Continued)

At January 2, 2010, we had approximately $130.0 million of cash invested in two Dreyfus Cash Management Funds. These 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.

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. Our interest rate swap agreements are classified as current as their terms span less than one year.

As of July 3, 2010, approximately $130.7 million of our $232.8 million of outstanding debt was hedged under interest rate swap agreements. These interest rate swap agreements mature at various times through January 2011. On July 30, 2010, an interest rate swap agreement of $30.7 million matured. As of January 2, 2010, approximately $238.9 million of our $334.5 million of outstanding debt was hedged under interest rate swap agreements. We continue to be in compliance with the 25% hedging requirement under our senior credit facility.

In fiscal 2006, the Company entered into an interest rate collar agreement which covered $100 million of our variable rate Term Loan debt and was designated as a cash flow hedge of the variable interest payments on such debt. The interest rate collar agreement matured on January 31, 2009.

The fair value of our derivative instruments in our accompanying unaudited condensed consolidated balance sheets were as follows:

	Asset Derivatives		Liability Derivatives	
(dollars in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
July 3, 2010	Prepaid expenses and other current assets	$ --	Other current liabilities	$ 0.6
January 2, 2010	Prepaid expenses and other current assets	$ --	Other current liabilities	$ 1.3

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

NOTE 7 – FAIR VALUE MEASUREMENTS: (Continued)

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

	For the three-month period ended July 3, 2010		For the six-month period ended July 3, 2010	
(dollars in thousands)	Amount of gain recognized in accumulated other comprehensive income (loss) on effective hedges (1)	Amount of loss reclassified from accumulated other comprehensive income (loss) into interest expense	Amount of gain recognized in accumulated other comprehensive income (loss) on effective hedges (1)	Amount of loss reclassified from accumulated other comprehensive income (loss) into interest expense
Interest rate hedge agreements	$ 297	$ (514)	$ 463	$ (1,149)

(1) Amount recognized in accumulated other comprehensive income (loss), net of tax of $174,000 and $272,000 for the three and six-month periods ended July 3, 2010, respectively.

	For the three-month period ended July 4, 2009		For the six-month period ended July 4, 2009	
(dollars in thousands)	Amount of gain recognized in accumulated other comprehensive income (loss) on	Amount of loss reclassified from accumulated other comprehensive income (loss) into interest expense	Amount of loss recognized in accumulated other comprehensive income (loss) on	Amount of loss reclassified from accumulated other comprehensive income (loss) into interest expense

	effective hedges (1)		effective hedges (1)	
Interest rate hedge agreements	$ 144	$ (541)	$ (3)	$ (1,414)

(1) Amount recognized in accumulated other comprehensive income (loss), net of tax of $85,000 and tax benefit of $2,000 for the three and six-month periods ended
July 4, 2009, respectively.

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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 7 "Employee Benefit Plans" to our audited consolidated financial statements in our most recently filed Annual Report on Form 10-K for further information.

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

	For the three-month periods ended		For the six-month periods ended	
(dollars in thousands)	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Service cost – benefits attributed to service during the period	$ 23	$ 23	$ 46	$ 46
Interest cost on accumulated post-retirement benefit obligation	133	113	266	226
Amortization net actuarial gain	(7)	(7)	(14)	(14)
Total net periodic post-retirement benefit cost	$ 149	$ 129	$ 298	$ 258

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 six-month periods ended	
(dollars in thousands)	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Interest cost on accumulated pension benefit obligation	$ 12	$ 13	$ 24	$ 26

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) expense associated with this pension plan and included in the statement of operations was comprised of:

	For the	For the six-month periods ended

(dollars in thousands)	three-month periods ended July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Interest cost on accumulated pension benefit obligation	$ 598	$ 568	$ 1,196	$ 1,135
Expected return on assets	(719)	(650)	(1,438)	(1,300)
Amortization of actuarial loss	33	102	67	205
Total net periodic pension (benefit) expense	$ (88)	$ 20	$ (175)	$ 40

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

NOTE 9 – COMMON STOCK:

During the second quarter and first half of fiscal 2010, the Company issued 24,032 shares of common stock at a fair market value of $33.29 per share to its non-management board members. In connection with this issuance, we recognized approximately $800,000 in stock-based compensation expense. During the second quarter and first half of fiscal 2009, the Company issued 33,656 shares of common stock at a fair market value of $20.80 per share to its non-management board members. In connection with this issuance, we recognized approximately $700,000 in stock-based compensation expense. We received no proceeds from the issuance of these shares.

On February 16, 2007, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company is authorized to purchase up to $100 million of its outstanding common shares. The Company did not repurchase any shares of its common stock during the three or six-month periods ended July 3, 2010 and July 4, 2009 pursuant to the Company's share repurchase authorization. Since inception of the authorization and through July 3, 2010, the Company repurchased and retired 4,599,580 shares of its common stock at an average price of $19.81 per share, leaving approximately $8.9 million available for repurchase under the authorization. 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.

On June 15, 2010, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company is authorized to purchase up to $100 million of its outstanding common shares (in addition to the $8.9 million available for repurchases under the Company's repurchase authorization approved in February 2007). Neither of the current share repurchase authorizations have expiration dates. Purchases may be made in the open market or in privately negotiated transactions, with the level and timing of activity being at the discretion of the Company's management depending on market conditions, stock price, other investment priorities, and other factors.

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 six-month period ended July 3, 2010.

	Assumptions	
Volatility	34.60	%
Risk-free interest rate	3.08	%
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 six-month period ended July 3, 2010:

	Time-based stock options	Restricted stock
Outstanding, January 2, 2010	3,512,385	449,844
Granted	394,500	176,504
Exercised	(1,221,003)	--
Vested restricted stock	--	(86,731)
Forfeited	(100,600)	(36,900)
Expired	(9,800)	--
Outstanding, July 3, 2010	2,575,482	502,717
Exercisable, July 3, 2010	1,575,057	--

During the three-month period ended July 3, 2010, we granted 9,000 time-based stock options with a weighted-average Black-Scholes fair value of $13.92 per share and a weighted-average exercise price of $33.44 per share. In connection with this grant, we recognized approximately $4,000 in stock-based compensation expense during the three-month period ended July 3, 2010.

During the six-month period ended July 3, 2010, we granted 394,500 time-based stock options with a weighted-average Black-Scholes fair value of $11.94 per share and a weighted-average exercise price of $28.16 per share. In connection with these grants, we recognized approximately $410,000 in stock-based compensation expense during the six-month period ended July 3, 2010.

During the three-month period ended July 3, 2010, we granted 7,504 shares of restricted stock to employees and a director with a weighted-average fair value on the date of grant of $33.38 per share. In connection with these grants, we recognized approximately $9,000 in stock-based compensation expense during the three-month period ended July 3, 2010.

During the six-month period ended July 3, 2010, we granted 176,504 shares of restricted stock to employees and a director with a weighted-average fair value on the date of grant of $28.27 per share. In connection with these grants, we recognized approximately $430,000 in stock-based compensation expense during the six-month period ended July

3, 2010.

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
2010 (period from July 4 through January 1, 2011)	$1,496	$1,710	$3,206
2011	2,695	3,066	5,761
2012	2,079	2,347	4,426
2013	1,243	1,330	2,573
Total	$7,513	$8,453	$15,966

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

	For the three-month periods ended				For the six-month periods ended			
(dollars in thousands)	July 3, 2010	% of Total	July 4, 2009	% of Total	July 3, 2010	% of Total	July 4, 2009	% of Total
Net sales:								
Carter's:								
Wholesale	$ 111,248	34.0 %	$ 108,061	33.1 %	$ 257,506	35.0 %	$ 229,878	33.6 %
Retail (a)	113,593	34.7 %	110,127	33.7 %	231,732	31.5 %	212,057	31.0 %
Mass Channel	38,838	11.9 %	44,283	13.6 %	106,758	14.5 %	103,106	15.1 %
Carter's total net sales	263,679	80.6 %	262,471	80.4 %	595,996	81.0 %	545,041	79.7 %
OshKosh:								
Retail (a)	51,959	15.9 %	52,160	16.0 %	107,104	14.5 %	103,988	15.2 %
Wholesale	11,371	3.5 %	11,698	3.6 %	32,958	4.5 %	34,462	5.1 %
OshKosh total net sales	63,330	19.4 %	63,858	19.6 %	140,062	19.0 %	138,450	20.3 %
Total net sales	$ 327,009	100.0 %	$ 326,329	100.0 %	$ 736,058	100.0 %	$ 683,491	100.0 %
Operating income (loss):		% of segment net sales		% of segment net sales		% of segment net sales		% of segment net sales
Carter's:								
Wholesale	$ 23,341	21.0 %	$ 20,325	18.8 %	$ 63,639	24.7 %	$ 43,424	18.9 %
Retail (a)	18,683	16.4 %	16,575	15.1 %	44,826	19.3 %	33,163	15.6 %
Mass Channel	6,856	17.7 %	8,706	19.7 %	19,650	18.4 %	16,819	16.3 %
Carter's operating income	48,880	18.5 %	45,606	17.4 %	128,115	21.5 %	93,406	17.1 %

OshKosh:								
Retail (a)	(909)	(1.7 %)	786	1.5 %	1,054	1.0 %	455	0.4 %
Wholesale	(2,363)	(20.8 %)	(1,938)	(16.6 %)	1,230	3.7 %	(517)	(1.5 %)
Mass Channel (b)	474	--	438	--	1,239	--	1,144	--
OshKosh operating (loss) income	(2,798)	(4.4 %)	(714)	(1.1 %)	3,523	2.5 %	1,082	0.8 %
Segment operating income	46,082	14.1 %	44,892	13.8 %	131,638	17.9 %	94,488	13.8 %
Corporate expenses (c)	(12,659)	(3.9 %)	(11,910)	(3.6 %)	(27,046)	(3.7 %)	(23,830)	(3.5 %)
Workforce reduction and facility write-down and closure costs (d)	--	--	(3,623)	(1.1 %)	--	--	(12,365)	(1.8 %)
Net corporate expenses	(12,659)	(3.9 %)	(15,533)	(4.8 %)	(27,046)	(3.7 %)	(36,195)	(5.3 %)
Total operating income	$ 33,423	10.2 %	$ 29,359	9.0 %	$ 104,592	14.2 %	$ 58,293	8.5 %

(a) Includes eCommerce results.

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

(c) 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, and audit fees.

(d) Includes closure costs associated with our Barnesville, Georgia distribution facility and our Oshkosh, Wisconsin facility, write-down of the White House, Tennessee facility, and severance and other benefits related to the corporate workforce reduction.

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NOTE 12 – WORKFORCE REDUCTION AND FACILITY 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 included consolidating the majority of our operations performed in our Oshkosh, Wisconsin office into other Company locations. This consolidation has resulted in the addition of resources in our other locations.

As a result of this corporate workforce reduction, we recorded severance charges and other one-time benefits to eligible employees of $2.2 million in the second quarter of fiscal 2009. During the first half 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. The majority of the remaining severance payments will be paid by 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
Provision	--
Payments	(800)
Balance at January 2, 2010	2,500
Provision	--
Payments	(1,000)
	1,500

Balance at April 3, 2010	
Provision	--
Payments	(600)
Balance at July 3, 2010	$ 900

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.

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE 12 – WORKFORCE REDUCTION AND FACILITY CLOSURE COSTS: (Continued)

In conjunction with the plan to close the Barnesville, Georgia distribution center, the Company recorded accelerated depreciation charges (included in selling, general, and administrative expenses) of approximately $0.7 million in the second quarter of fiscal 2009 and charges of $4.3 million during the first half 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.

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
Provision	--	--	--
Payments	(50)	--	(50)
Balance at January 2, 2010	50	500	550
Provision	--	--	--
Payments	--	--	--
Balance at April 3, 2010	50	500	550
Provision	--	--	--
Payments	--	(50)	(50)
Balance at July 3, 2010	$ 50	$ 450	$ 500

White House Distribution Facility

During the second quarter and first half 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 of the facility at that time. During the third quarter of fiscal 2009, the Company sold the facility for net proceeds of approximately $2.8 million.

NOTE 13 – EARNINGS PER SHARE:

The Company calculates basic and diluted net income per common share in accordance with 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).

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.

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NOTE 13 – EARNINGS PER SHARE: (Continued)

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 six-month periods ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Weighted-average number of common and common equivalent shares outstanding:				
Basic number of common shares outstanding	58,907,191	56,220,522	58,607,261	56,089,674
Dilutive effect of unvested restricted stock	118,416	122,781	119,227	116,583
Dilutive effect of stock options	760,254	1,787,646	864,836	1,727,956
Diluted number of common and common equivalent shares outstanding	59,785,861	58,130,949	59,591,324	57,934,213
Basic net income per common share:				
Net income	$ 19,096,000	$ 16,634,000	$ 61,921,000	$ 33,238,000
Income allocated to participating securities	(161,587)	(137,414)	(526,624)	(275,215)
Net income available to common shareholders	$ 18,934,413	$ 16,496,586	$ 61,394,376	$ 32,962,785