CARTERS INC
Form 10-Q
November 02, 2012

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 SEPTEMBER 29, 2012 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 (X) 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 November 1, 2012

Common stock, par value $0.01 per share	59,033,166

CARTER’S, INC.
INDEX

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 29, 2012	December 31, 2011	October 1, 2011
ASSETS			
Current assets:			
Cash and cash equivalents	$254,321	$233,494	$81,634
Accounts receivable, net	200,156	157,754	214,558
Finished goods inventories, net	375,102	347,215	385,960
Prepaid expenses and other current assets	16,913	18,519	16,412
Deferred income taxes	29,984	25,165	24,384
Total current assets	876,476	782,147	722,948
Property, plant, and equipment, net	153,330	122,346	111,830
Tradenames	305,962	306,176	306,234
Goodwill	190,470	188,679	186,536
Deferred debt issuance costs, net	3,074	2,624	2,801
Other intangible assets, net	210	258	268
Other assets	3,268	479	499
Total assets	$1,532,790	$1,402,709	$1,331,116
LIABILITIES AND STOCKHOLDERS’ EQUITY			
Current liabilities:			
Current maturities of long-term debt	$—	$—	$—
Accounts payable	115,005	102,804	83,491
Other current liabilities	89,158	49,949	42,426
Total current liabilities	204,163	152,753	125,917
Long-term debt	186,000	236,000	236,000
Deferred income taxes	113,280	114,421	115,982
Other long-term liabilities	95,905	93,826	81,600
Total liabilities	599,348	597,000	559,499
Commitments and contingencies			
Stockholders’ equity:			
Preferred stock; par value $.01 per share; 100,000 shares authorized; none issued or outstanding at September 29, 2012, December 31, 2011, and October 1, 2011	—	—	—
Common stock, voting; par value $.01 per share; 150,000,000 shares authorized; 59,035,891, 58,595,421, and 58,529,586 shares issued and outstanding at September 29, 2012, December 31, 2011, and October 1, 2011, respectively	590	586	585

Additional paid-in capital	244,861	231,738	228,061
Accumulated other comprehensive loss	(9,134)	(11,282)	(6,911)
Retained earnings	697,125	584,667	549,882
Total stockholders’ equity	933,442	805,709	771,617
Total liabilities and stockholders’ equity	$1,532,790	$1,402,709	$1,331,116

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	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Net sales	$668,657	$639,617	$1,692,481	$1,503,105
Cost of goods sold	398,580	447,504	1,044,422	1,017,864
Gross profit	270,077	192,113	648,059	485,241
Selling, general, and administrative expenses	185,167	145,842	491,162	380,912
Royalty income	(10,482)	(10,494)	(26,722)	(28,092)
Operating income	95,392	56,765	183,619	132,421
Interest expense, net	1,716	1,699	5,411	5,305
Foreign currency gain	(249)	(88)	(150)	(319)
Income before income taxes	93,925	55,154	178,358	127,435
Provision for income taxes	34,547	20,705	65,900	48,204
Net income	$59,378	$34,449	$112,458	$79,231
Basic net income per common share (Note 13)	$1.01	$0.59	$1.91	$1.37
Diluted net income per common share (Note 13)	$0.99	$0.58	$1.88	$1.35

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	For the three-month periods ended		For the nine-month periods ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Net income	$59,378	$34,449	$112,458	$79,231
Other comprehensive income (loss):				
Cumulative foreign currency translation adjustments	2,293	(4,922)	2,148	(5,021)
Comprehensive income	$61,671	$29,527	$114,606	$74,210

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 December 31, 2011	$586	$231,738	$(11,282)	$584,667	$805,709
Exercise of stock options (166,600 shares)	2	3,648	—	—	3,650
Issuance of common stock (21,708)	—	1,080	—	—	1,080
Withholdings from vesting of restricted stock (60,542 shares)	(1)	(2,793)	—	—	(2,794)
Income tax benefit from stock-based compensation	—	2,387	—	—	2,387
Restricted stock activity	3	(3)	—	—	—
Stock-based compensation expense	—	8,804	—	—	8,804
Net income	—	—	—	112,458	112,458
Cumulative foreign currency translation adjustments	—	—	2,148	—	2,148
Balance at September 29, 2012	$590	$244,861	$(9,134)	$697,125	$933,442

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 29, 2012	October 1, 2011
Cash flows from operating activities:		
Net income	$112,458	$79,231
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	26,338	23,522
Amortization of Bonnie Togs inventory step-up	—	5,944
Non-cash revaluation of contingent consideration	2,883	1,020
Amortization of Bonnie Togs tradename and non-compete agreements	281	96
Amortization of debt issuance costs	681	531
Non-cash stock-based compensation expense	9,718	7,161
Income tax benefit from stock-based compensation	(2,387)	(6,292)
Loss on disposal of property, plant, and equipment	747	149
Deferred income taxes	(5,612)	8,021
Effect of changes in operating assets and liabilities:		
Accounts receivable	(42,209)	(90,263)
Inventories	(26,963)	(59,355)
Prepaid expenses and other assets	(332)	1,019
Accounts payable and other liabilities	53,612	(56,572)
Net cash provided by (used in) operating activities	129,215	(85,788)
Cash flows from investing activities:		
Capital expenditures	(59,816)	(29,157)
Acquisition of Bonnie Togs	—	(61,199)
Proceeds from sale of property, plant, and equipment	6	10
Net cash used in investing activities	(59,810)	(90,346)
Cash flows from financing activities:		
Borrowings under revolving credit facility	2,500	—
Payments on revolving credit facility	(52,500)	—
Payment of debt issuance costs	(1,916)	—
Income tax benefit from stock-based compensation	2,387	6,292
Withholdings from vesting of restricted stock	(2,794)	(1,635)
Proceeds from exercise of stock options	3,650	5,428
Net cash (used in) provided by financing activities	(48,673)	10,085
Effect of exchange rate changes on cash	95	301
Net increase (decrease) in cash and cash equivalents	20,827	(165,748)
Cash and cash equivalents, beginning of period	233,494	247,382

Cash and cash equivalents, end of period	$254,321	$81,634

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, Precious Firsts, OshKosh, and other brands. Our products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic and international retailers and for our 398 Carter's, 167 OshKosh, and 79 Canadian retail stores that market our brand name merchandise and other licensed products manufactured by other companies.

On June 30, 2011, we purchased Bonnie Togs (the "Acquisition"), a Canadian specialty retailer focused exclusively on the children's apparel and accessories marketplace. Prior to the Acquisition, Bonnie Togs was a significant international licensee of the Company.

As a result of the acquisition of Bonnie Togs, the Company reevaluated and realigned certain of its reportable segments, please see Note 12, "Segment Information."

Our unaudited condensed consolidated balance sheets as of September 29, 2012 and October 1, 2011 and our audited consolidated balance sheet as of December 31, 2011 include Bonnie Togs. The unaudited condensed consolidated statements of operations for the three and nine-month periods ended October 1, 2011 include Bonnie Togs, effective the date of the Acquisition.

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 statement of our financial position as of September 29, 2012, the results of our operations for the three and nine-month periods ended September 29, 2012 and October 1, 2011, comprehensive income for the three and nine-month periods ended September 29, 2012 and October 1, 2011, changes in stockholders' equity for the nine-month period ended September 29, 2012, and cash flows for the nine-month periods ended September 29, 2012 and October 1, 2011. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the three and nine-month periods ended September 29, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending December 29, 2012. Our accompanying condensed consolidated balance sheet as of December 31, 2011 is derived 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 December 31, 2011.

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 2012 reflects our financial position as of September 29, 2012. The third quarter and first nine months of fiscal 2011 ended on October 1, 2011.

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

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

NOTE 3 – ACQUISITION OF BONNIE TOGS:

On June 30, 2011, The Company purchased all of the outstanding shares of capital stock of Bonnie Togs for total consideration of up to CAD $95 million, of which USD $61.2 million was paid in cash at closing. The sellers may also be paid contingent consideration ranging from zero to CAD $35 million if the Canadian business meets certain earnings targets for the period beginning July 1, 2011 and ending on June 27, 2015. Sellers may receive a portion of the contingent consideration of up to CAD $25 million if interim earnings targets are met through June 2013 and June 2014, respectively. Any such payments are not recoverable by the Company in the event of any failure to meet overall targets.

The Company had a discounted contingent consideration liability of approximately $29.4 million as of September 29, 2012, approximately $25.6 million as of December 31, 2011, and approximately $23.4 million as of October 1, 2011, based upon the high probability that Bonnie Togs will attain its earnings targets. As of September 29, 2012, approximately $14.4 million of the contingent consideration liability is included in other current liabilities and the remainder is included in other long-term liabilities, on the accompanying unaudited condensed consolidated balance sheet. The $2.1 million increase in fair value during the third quarter of fiscal 2012 reflects accretion expense of approximately $1.1 million and a $1.0 million unfavorable foreign currency translation adjustment reflected in accumulated other comprehensive income. The $3.8 million increase in the fair value of the liability during the first nine months of fiscal 2012 reflects accretion expense of approximately $2.9 million and a $0.9 million unfavorable foreign currency translation adjustment reflected in accumulated other comprehensive income. The Company determined the fair value of the contingent consideration based upon a probability-weighted discounted cash flow analysis and will continue to revalue the contingent consideration at each reporting date.
The following table summarizes the fair values of the assets acquired and liabilities assumed at June 30, 2011, the date of the Acquisition:
(U.S. dollars in thousands)

Current assets	$40,668
Property, plant, and equipment	13,485
Bonnie Togs Goodwill	54,982
Bonnie Togs tradename	623
Non-compete agreements	311
Total assets acquired	110,069
Current liabilities	18,231
Non-current liabilities	6,693
Total liabilities assumed	24,924
Net assets acquired	$85,145

In connection with the Acquisition, the Company recorded total acquired intangible assets of approximately $55.9 million, including $55.0 million of Bonnie Togs goodwill, $0.6 million related to the Bonnie Togs tradename (life of two years), and $0.3 million related to non-compete agreements for certain executives (life of four years).

The following unaudited pro forma summary presents information as if Bonnie Togs had been acquired on January 2, 2011 and assumes that there were no other changes in our operations. The pro forma information does not necessarily reflect the actual results that would have occurred had the Company operated the Canadian business since January 2, 2011, nor is it necessarily indicative of the future results of operations of the combined companies.

(dollars in thousands, except share data)	Nine-month period ended October 1, 2011
Pro forma net sales	$1,549,334
Pro forma net income	$86,155
Pro forma basic earnings per share	$1.48
Pro forma diluted earnings per share	$1.47

7

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

NOTE 4 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):

The components of accumulated other comprehensive income (loss) consisted of the following:

(dollars in thousands)	September 29, 2012	December 31, 2011	October 1, 2011
Cumulative foreign currency translation adjustments	$(976)	$(3,124)	$(5,021)
Pension/post-retirement liability adjustment	(8,158)	(8,158)	(1,890)
Total accumulated other comprehensive loss	$(9,134)	$(11,282)	$(6,911)

NOTE 5 – LONG-TERM DEBT:

Long-term debt consisted of the following:

(dollars in thousands)	September 29, 2012	December 31, 2011	October 1, 2011
Revolving credit facility	$186,000	$236,000	$236,000
Current maturities	—	—	—
Total long-term debt	$186,000	$236,000	$236,000

Revolving Credit Facility

On October 15, 2010, the Company entered into a $375 million ($130 million sub-limit for letters of credit and a swing line sub-limit of $40 million) revolving credit facility with Bank of America as sole lead arranger and administrative agent, JP Morgan Chase Bank as syndication agent, and other financial institutions. This revolving credit facility was immediately drawn upon to pay off the Company's former term loan of $232.2 million and pay transaction fees and expenses of $3.8 million, leaving approximately $130 million available under the revolver for future borrowings (net of letters of credit of approximately $8.6 million). In connection with the repayment of the Company's former term loan, in the fourth quarter of fiscal 2010 the Company wrote off approximately $1.2 million in unamortized debt issuance costs. In addition, in connection with the revolving credit facility, the Company recorded $3.5 million of debt issuance costs to be amortized over the term of the revolving credit facility.

On December 22, 2011, the Company and lenders amended and restated the revolving credit facility to, among other things, provide a U.S. dollar revolving facility of $340 million ($130 million sub-limit for letters of credit and a swing line sub-limit of $40 million) and a $35 million multicurrency revolving facility ($15 million sub-limit for letters of credit and a swing line sub-limit of $5 million), which is available for borrowings by either TWCC or our Canadian subsidiary, in U.S. dollars or Canadian dollars.

On August 31, 2012, the Company and lenders amended and restated the revolving credit facility to, among other things, improve interest rates applicable to pricing, extend the maturity of the facility, and allow borrowings in currencies other than U.S. dollars or Canadian dollars subject to the consent of all multicurrency lenders. The aggregate principal amount of the facility remained unchanged at $375 million consisting of a $340 million U.S. dollar revolving credit facility and a $35 million multicurrency revolving credit facility (although the sub-limit for U.S. dollar letters of credit was increased to $175 million). In connection with the amendment, the Company recorded approximately $1.9 million in debt issuance costs which, together with the existing unamortized debt issuance costs, will be amortized over the new remaining term of the facility (five years). The term of the revolving credit facility expires August 31, 2017.

During the first nine months of fiscal 2012, the Company repaid borrowings under its revolving credit facility of $50.0 million. At September 29, 2012, we had approximately $186.0 million in revolver borrowings (fair value approximates book value), exclusive of $11.4 million of outstanding letters of credit, at an effective interest rate of 1.97%.

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

NOTE 5 – LONG-TERM DEBT: (Continued)

Pricing Options

The revolving credit facility provides for two pricing options for U.S. dollar facility revolving loans: (i) revolving loans on which interest is payable quarterly at a base rate equal to the highest of (x) the Federal Funds Rate plus ½ of 1%, (y) the rate of interest in effect for such day as publicly announced from time to time by Bank of America, N.A. as its prime rate, or (z) the Eurodollar Rate plus 1%, plus, in each case, an applicable margin initially equal to 0.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 0.50% to 1.25% and (ii) revolving loans on which interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

The revolving credit facility also provides for two pricing options for multicurrency facility revolving loans denominated in U.S. dollars: (i) revolving loans on which interest is payable quarterly at a base rate equal to the highest of (x) the Federal Funds Rate plus ½ of 1%, (y) the rate of interest in effect for such day as publicly announced from time to time by Bank of America, N.A., Canada Branch in Toronto as its reference rate for loans in U.S. dollars to its Canadian borrowers, or (z) the Eurodollar Rate plus 1%, plus, in each case, an applicable margin initially equal to 0.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 0.50% to 1.25% and (ii) revolving loans on which interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

In addition, the revolving credit facility provides for two pricing options for multicurrency facility revolving loans denominated in Canadian dollars: (i) revolving loans on which interest is payable quarterly at a base rate equal to the highest of (x) the rate of interest in effect for such day as publicly announced from time to time by Bank of America, N.A., Canada Branch in Toronto as its prime rate for loans in Canadian Dollars to Canadian Borrowers and (y) the rate of interest in effect for such day for Canadian dollar bankers' acceptances having a term of one month that appears on the Reuters Screen CDOR Page plus ½ of 1%, plus, in each case, an applicable margin initially equal to 0.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 0.50% to 1.25%, and (ii) revolving loans on which interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

The multicurrency revolving facility also provides for borrowings in currencies other than U.S. Dollars or Canadian dollars, subject to certain limitations. For such multicurrency revolving loans, interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

Amounts outstanding under the revolving credit facility currently accrue interest at a LIBOR rate plus 1.75%.

Covenants

The revolving credit facility contains and defines financial covenants, including a lease adjusted leverage ratio (defined as, with certain adjustments, the ratio of the Company's consolidated indebtedness plus six times rent expense to consolidated net income before interest, taxes, depreciation, amortization, and rent expense ("EBITDAR")) to exceed (x) if such period ends on or before December 31, 2016, 3.75:1.00 and (y) if such period ends after December 31, 2016, 3.50:1.00; and consolidated fixed charge coverage ratio (defined as, with certain adjustments, the ratio of consolidated EBITDAR to consolidated fixed charges (defined as interest plus rent expense)), for any such period to be less than 2.50:1.00. As of September 29, 2012, the Company believes it was in compliance with its financial debt covenants.

Provisions in our senior credit facility currently restrict the ability of our operating subsidiary, The William Carter Company ("TWCC"), from paying cash dividends to our parent company, Carter's, Inc., in excess of $15.0 million unless TWCC and its consolidated subsidiaries meet certain leverage ratio and minimum availability requirements under the credit facility, which materially restricts Carter's, Inc. from paying cash dividends on our common stock. We do not anticipate paying cash dividends on our common stock in the foreseeable future but intend to retain future earnings, if any, for reinvestment in the future operation and expansion of our business and related development activities. Any future decision to pay cash dividends will be at the discretion of our Board of Directors and will depend upon our financial condition, results of operations, terms of financing arrangements, capital requirements, and any other factors as our Board of Directors deems relevant.

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

NOTE 6 – GOODWILL AND OTHER INTANGIBLE ASSETS:

In connection with the Acquisition, the Company recorded goodwill and other intangible assets including a Bonnie Togs tradename and non-compete agreements for certain executives of Bonnie Togs, in accordance with accounting guidance on business combinations.

Goodwill as of September 29, 2012, represents the excess of the cost of the acquisition of Carter’s, Inc., which was consummated on August 15, 2001, and the acquisition of Bonnie Togs, which was consummated on June 30, 2011, over the fair value of the net assets acquired. Our goodwill is not deductible for tax purposes. The OshKosh tradename was recorded in connection with the acquisition of OshKosh on July 14, 2005 and adjusted in fiscal 2007 to reflect the impairment of the value. Our Carter’s and Bonnie Togs goodwill and Carter’s and OshKosh tradenames are deemed to have indefinite lives and are not being amortized. The Bonnie Togs tradename and non-compete agreements for certain executives have definite lives and are being amortized over two and four years, respectively.

The Company’s intangible assets were as follows:

		September 29, 2012			December 31, 2011		
(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
Bonnie Togs goodwill (2)	Indefinite	$53,900	$—	$53,900	$52,109	$—	$52,109
Carter’s tradename	Indefinite	$220,233	$—	$220,233	$220,233	$—	$220,233
OshKosh tradename	Indefinite	$85,500	$—	$85,500	$85,500	$—	$85,500
Bonnie Togs tradename	2 years	$612	$383	$229	$592	$150	$442
Non-compete agreements	4 years	$305	$95	$210	$295	$37	$258

		October 1, 2011		
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount
Carter’s goodwill (1)	Indefinite	$136,570	$—	$136,570
Bonnie Togs goodwill (2)	Indefinite	$49,966	$—	$49,966
Carter’s tradename	Indefinite	$220,233	$—	$220,233
OshKosh tradename	Indefinite	$85,500	$—	$85,500
Bonnie Togs tradename	2 years	$576	$75	$501
Non-compete agreements	4 years	$287	$19	$268

(1) $45.9 million of which relates to the Carter’s wholesale segment, $82.0 million of which relates to the Carter’s retail segment, and $8.6 million of which relates to the international segment.
(2) Relates to the international segment.

The following is a reconciliation of Bonnie Togs' intangible assets:

(dollars in thousands)	Bonnie Togs Goodwill	Bonnie Togs Tradename	Non-compete agreements
Gross Balance at December 31, 2011	$52,109	$592	$295
Foreign currency exchange adjustments	1,791	20	10
Gross Balance at September 29, 2012	$53,900	$612	$305

Amortization expense for intangible assets subject to amortization was approximately $0.1 million and $0.3 million for the three and nine-month periods ended September 29, 2012, respectively. Amortization expense for intangible assets subject to amortization was approximately $0.1 million for both the three and nine-month periods ended October 1, 2011.

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

NOTE 7 – INCOME TAXES:

The Company and its subsidiaries file income tax returns in the United States and in various states and local jurisdictions. The Company's subsidiaries also file income tax returns in Canada and Hong Kong, as well as various Canadian provinces. The Internal Revenue Service completed its income tax audit for fiscal 2009 during fiscal 2011. The federal statute of limitations for fiscal 2008 closed during the third quarter of fiscal 2012. In most cases, the Company is no longer subject to state and local tax authority examinations for years prior to fiscal 2007.

During the third quarter of fiscal 2012 and 2011, we reversed approximately $0.8 million and $0.3 million, respectively, of reserves for which the statute of limitations expired during the respective quarter.

As of September 29, 2012, the Company had gross unrecognized tax benefits of approximately $10.1 million, $6.9 million of which, 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 are approximately $1.7 million of reserves for which the statute of limitations is expected to expire within the next fiscal year. If these tax benefits are ultimately recognized, such recognition, net of federal income taxes, may impact our annual effective tax rate for fiscal 2012 or 2013 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 third quarter of fiscal 2012, interest expense recorded on uncertain tax positions was not material. During the third quarter of fiscal 2011, the Company recognized a reduction of interest expense on uncertain tax positions of approximately $0.1 million. During the nine-month periods ended September 29, 2012 and October 1, 2011, the Company recognized interest expense on uncertain tax positions of approximately $0.2 million and $0.1 million, respectively. The Company had approximately $0.7 million, $0.5 million, and $0.7 million of interest accrued on uncertain tax positions as of September 29, 2012, December 31, 2011, and October 1, 2011, respectively.

NOTE 8 – FAIR VALUE MEASUREMENTS:

The Company accounts for 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:

	September 29, 2012			December 31, 2011			October 1, 2011		
(dollars in millions)	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3

Assets									
Investments	$50.3	$—	$—	$50.2	$—	$—	$25.2	$—	$—
Foreign exchange forward contracts	$—	$—	$—	$0.6	$—	$—	$1.1	$—	$—
Liabilities									
Foreign exchange forward contracts	$0.1	$—	$—	$—	$—	$—	$—	$—	$—
Contingent consideration	$—	$—	$29.4	$—	$—	$25.6	$—	$—	$23.4

11

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

NOTE 8 – FAIR VALUE MEASUREMENTS: (Continued)

The following summarizes the significant unobservable inputs for our Level 3 fair value measurements at September 29, 2012:

(dollars in millions)	Fair Value	Valuation technique	Unobservable inputs	Amount	
Contingent consideration	$29.4	Discounted cash flow	Estimated contingent consideration payment	$35	
			Discount rate	17	%
			Probability assumption	100	%

At September 29, 2012, December 31, 2011, and October 1, 2011, we had approximately $50.3 million, $50.2 million, and $25.2 million of cash invested in money market deposit accounts.

As of September 29, 2012, December 31, 2011, and October 1, 2011, the fair value of the Company's outstanding borrowings under the revolving credit facility approximated book value and would have been disclosed as a Level 1 liability in the fair value hierarchy had it been measured at fair value.

As part of the Company's overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, primarily exposure to changes in the value of the U.S. dollar in relation to the Canadian dollar, the Company hedges a portion of its foreign currency exposures anticipated over the ensuing twelve-month period. The Company uses foreign exchange contracts that generally have maturities of up to 12 months to provide continuing coverage throughout the hedging period.

As of September 29, 2012, the Company had contracts for the purchase of $8.0 million of U.S. dollars at fixed rates. The fair value of these forward contracts was a liability of $0.1 million. The Company accounts for these foreign exchange contracts as undesignated positions in accordance with accounting standards on derivatives and hedging. As such, these positions are marked to fair value through earnings at each reporting date.

During the third quarter of fiscal 2012, the Company also recorded a $0.4 million loss on the mark-to-market of foreign currency exchange contracts and a $0.6 million gain on the remeasurement of foreign denominated payables. During the first nine months of fiscal 2012, the Company recorded an $0.8 million loss on the mark-to-market of foreign currency exchange contracts and a $1.0 million gain on the remeasurement of foreign denominated payables.

The fair value of the discounted contingent consideration liability was approximately $29.4 million as of September 29, 2012, $25.6 million as of December 31, 2011, and $23.4 million as of October 1, 2011. The $2.1 million increase in fair value during the third quarter of fiscal 2012, reflects accretion expense of approximately $1.1 million and a $1.0 million unfavorable foreign currency translation adjustment reflected in accumulated other comprehensive income. The $3.8 million increase in fair value during the first nine months of fiscal 2012, reflects accretion expense of approximately $2.9 million and a $0.9 million unfavorable foreign currency translation adjustment reflected in accumulated other comprehensive income. The Company determined the fair value of the contingent consideration based upon a probability-weighted discounted cash flow analysis. Changes in the estimated earnout payment, discount rate, or probability assumptions used could materially impact the fair value of the contingent consideration.

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

NOTE 8 – FAIR VALUE MEASUREMENTS: (Continued)

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
September 29, 2012	Prepaid expenses and other current assets	$—	Other current liabilities	$0.1
December 31, 2011	Prepaid expenses and other current assets	$0.6	Other current liabilities	$—
October 1, 2011	Prepaid expenses and other current assets	$1.1	Other current liabilities	$—

The effect of undesignated derivative instruments on our accompanying unaudited condensed consolidated statements of operations was as follows:

	For the three-month periods ended		For the nine-month periods ended	
(dollars in thousands)	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Foreign exchange forward contracts gains (losses)	$(356)	$1,549	$(860)	$1,780

NOTE 9 – 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 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 nine-month periods ended
(dollars in thousands)		

	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Service cost – benefits attributed to service during the period	$17	$18	$51	$54
Interest cost on accumulated post-retirement benefit obligation	53	106	159	318
Amortization net actuarial gain	(18)	(5)	(54)	(15)
Total net periodic post-retirement benefit cost	$52	$119	$156	$357

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

NOTE 9 – EMPLOYEE BENEFIT PLANS: (Continued)

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:

(dollars in thousands)	For the three-month periods ended		For the nine-month periods ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Interest cost on accumulated pension benefit obligation	$20	$7	$60	$23

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:

(dollars in thousands)	For the three-month periods ended		For the nine-month periods ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Interest cost on accumulated pension benefit obligation	$597	$614	$1,791	$1,841
Expected return on assets	(713)	(779)	(2,139)	(2,335)
Amortization of actuarial loss	178	1	533	1
Total net periodic pension expense (benefit)	$62	$(164)	$185	$(493)

NOTE 10 – COMMON STOCK:

During the first nine months of 2012, the Company issued 21,708 shares of common stock at a fair value of $49.76 per share to non-management board members. In connection with this issuance, the Company recognized approximately $1.1 million in stock-based compensation expense. During the first nine months of fiscal 2011, the Company issued 38,520 shares of common stock at a fair value of $30.38 per share to its non-management board members. In connection with this issuance, we recognized approximately $1.2 million in stock-based compensation expense. The Company received no proceeds from the issuance of these shares.

During fiscal 2007, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company was authorized to purchase up to $100 million of its outstanding common shares. During fiscal 2010, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company is authorized to purchase up to an additional $100 million of its outstanding common shares. As of August 13, 2010, the Company had repurchased outstanding shares in the amount totaling the entire $100 million authorized by the Board of Directors on February 16, 2007.
The Company did not repurchase any shares of its common stock during the first nine months of fiscal 2012 and 2011 pursuant to any repurchase authorization. Since inception of the repurchase program and through the first nine months

of fiscal 2012, the Company repurchased and retired 6,658,410 shares, or approximately $141.1 million, of its common stock at an average price of $21.19 per share. 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. Future repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, other investment priorities, and other factors.

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

NOTE 11 – STOCK-BASED COMPENSATION:

Under the Company's Amended and Restated Equity Incentive Plan (the "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 (including restricted stock units), and performance-based stock 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 September 29, 2012.

	Assumptions
Volatility	34.8 %
Risk-free interest rate	1.37 %
Expected term (years)	5.9
Dividend yield	—
Grant-date fair value	$15.16

The fair value of restricted stock and restricted stock units (collectively, "restricted stock awards") is determined based on the quoted closing price of our common stock on the date of grant.

The following table summarizes our stock option and restricted stock awards activity during the nine-month period ended September 29, 2012:

	Stock options	Restricted stock awards
Outstanding, December 31, 2011	1,992,700	617,401
Granted	351,000	327,500
Exercised	(166,600)	—
Vested restricted stock	—	(165,211)
Forfeited	(18,250)	(9,000)
Expired	—	—
Outstanding, September 29, 2012	2,158,850	770,690
Exercisable, September 29, 2012	1,222,286	

During the three-month period ended September 29, 2012, we granted 5,400 stock options with a weighted-average Black-Scholes fair value of $18.11 per share and a weighted-average exercise price of $52.63 per share. In connection with this grant, we recognized approximately $2,800 in stock-based compensation expense during the three-month period ended September 29, 2012.

During the nine-month period ended September 29, 2012, we granted 351,000 stock options with a weighted-average Black-Scholes fair value of $15.16 per share and a weighted-average exercise price of $42.81 per share. In connection with these grants, we recognized approximately $732,000 in stock-based compensation expense during the nine-month period ended September 29, 2012.

During the three-month period ended September 29, 2012, we granted 2,700 restricted stock awards with a weighted-average fair value on the date of grant of $52.63 per share. In connection with these grants, we recognized approximately $4,000 in stock-based compensation expense during the three-month period ended September 29, 2012.

During the nine-month period ended September 29, 2012, we granted 327,500 restricted stock awards with a weighted-average fair value on the date of grant of $42.72 per share. In connection with these grants, we recognized approximately $2.1 million in stock-based compensation expense during the nine-month period ended September 29, 2012.

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

NOTE 11 – STOCK-BASED COMPENSATION: (Continued)

During the nine-month period ended September 29, 2012, the Company granted our Chief Executive Officer 100,000 performance-based restricted shares at a fair market value of $42.61 per share. In addition, the Company granted our other executive officers 52,000 performance-based restricted shares at a fair market value of $42.61 per share. Vesting of these shares is contingent upon meeting specific performance targets and would occur, if ever, in fiscal 2015. Currently, the Company believes that these targets will be achieved and, accordingly, we will continue to record compensation expense until the restricted shares vest or the Company’s assessment of achievement of the performance criteria changes.

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)	Stock options	Restricted stock awards	Total
2012 (period from September 30 through December 29, 2012)	$1,013	$2,056	$3,069
2013	3,554	7,296	10,850
2014	2,597	6,253	8,850
2015	1,454	3,380	4,834
Total	$8,618	$18,985	$27,603

NOTE 12 – 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 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.

As a result of the Acquisition, the Company realigned certain of its reportable segments. Effective October 1, 2011, the Company's reportable segments include Carter’s retail, Carter’s wholesale, OshKosh retail, OshKosh wholesale, and international.

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

NOTE 12 – SEGMENT INFORMATION: (Continued)

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					
	September 29, 2012	% of Total		October 1, 2011	% of Total		September 29 2012	% of Total		October 1, 2011	% of Total	
Net sales:												
Carter's Wholesale	$275,577	41.2	%	$288,775	45.1	%	$719,585	42.5	%	$703,028	46.7	%
Carter's Retail (a)	217,299	32.5	%	184,498	28.9	%	563,764	33.3	%	465,281	31.0	%
Total Carter's	492,876	73.7	%	473,273	74.0	%	1,283,349	75.8	%	1,168,309	77.7	%
OshKosh Retail (a)	78,070	11.7	%	80,472								