

CARTERS INC  
Form 10-Q  
November 01, 2010

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

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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 OCTOBER 2, 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

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CARTER'S, INC.  
(Exact name of Registrant as specified in its charter)

Delaware 13-3912933  
(state or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

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)

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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

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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 October 29, 2010
Common stock, par value \$0.01 per share	57,474,937

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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)

	October 2, 2010	January 2, 2010	October 3, 2009
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**ASSETS****Current assets:**

Cash and cash equivalents	\$ 182,329	\$ 335,041	\$ 214,339
Accounts receivable, net	171,501	82,094	127,879
Finished goods inventories, net	263,782	214,000	223,510
Prepaid expenses and other current assets	12,369	11,114	11,845
Deferred income taxes	25,701	33,419	32,005
<b>Total current assets</b>	<b>655,682</b>	<b>675,668</b>	<b>609,578</b>
Property, plant, and equipment, net	92,558	86,077	84,430
Tradenames	305,733	305,733	305,733
Goodwill	136,570	136,570	136,570
Deferred debt issuance costs, net	1,237	2,469	2,750
Licensing agreements, net	--	1,777	2,597
Other assets	305	305	405
<b>Total assets</b>	<b>\$ 1,192,085</b>	<b>\$ 1,208,599</b>	<b>\$ 1,142,063</b>

**LIABILITIES AND  
STOCKHOLDERS' EQUITY****Current liabilities:****Current maturities of long-term debt**

Accounts payable	\$ 2,450	\$ 3,503	\$ 3,503
Other current liabilities	94,440	97,546	68,009
<b>Total current liabilities</b>	<b>62,502</b>	<b>69,568</b>	<b>69,808</b>
Long-term debt	159,392	170,617	141,320
Deferred income taxes	229,709	331,020	331,896
Other long-term liabilities	109,855	110,676	106,646
<b>Total liabilities</b>	<b>45,626</b>	<b>40,262</b>	<b>43,628</b>

**Commitments and contingencies****Stockholders' equity:**

	--	--	--
--	----	----	----

Preferred stock; par value \$.01 per share; 100,000 shares authorized; none issued or outstanding at October 2, 2010, January 2, 2010, and October 3, 2009

Common stock, voting; par value \$.01 per share; 150,000,000 shares authorized; 57,696,317, 58,081,822, and 58,037,018 shares issued and outstanding at October 2, 2010, January 2, 2010, and October 3, 2009, respectively

	577	581	580
Additional paid-in capital	214,547	235,330	233,565
Accumulated other comprehensive loss	(3,378 )	(4,066 )	(6,755 )
Retained earnings	435,757	324,179	291,183
 Total stockholders' equity	 647,503	 556,024	 518,573

Total liabilities and stockholders' equity	\$ 1,192,085	\$ 1,208,599	\$ 1,142,063
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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 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Net sales	\$ 517,928	\$ 481,506	\$ 1,253,986	\$ 1,164,997
Cost of goods sold	325,125	295,942	764,122	727,001
Gross profit	192,803	185,564	489,864	437,996
Selling, general, and administrative expenses	123,321	115,225	333,084	314,198
Workforce reduction and facility write-down and closure costs	--	--	--	11,400
Royalty income	(10,396 )	(10,637 )	(27,690 )	(26,871 )
Operating income	79,878	80,976	184,470	139,269
Interest expense, net	1,568	2,688	6,674	8,571
Income before income taxes	78,310	78,288	177,796	130,698
Provision for income taxes	28,653	28,882	66,218	48,054
Net income	\$ 49,657	\$ 49,406	\$ 111,578	\$ 82,644
Basic net income per common share (Note 13)	\$ 0.84	\$ 0.86	\$ 1.89	\$ 1.45
Diluted net income per common share (Note 13)	\$ 0.83	\$ 0.84	\$ 1.86	\$ 1.41

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	
	October 2,	October 3,
	2010	2009
Cash flows from operating activities:		
Net income	\$ 111,578	\$ 82,644
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	22,730	24,396
Amortization of debt issuance costs	1,232	848
Non-cash stock-based compensation expense	5,397	5,200
Income tax benefit from exercised stock options	(8,973 )	(11,374 )
Non-cash asset impairment and facility write-down charges	--	3,662
(Gain) loss on sale of property, plant, and equipment	(3 )	96
Deferred income taxes	6,974	1,310
Effect of changes in operating assets and liabilities:		
Accounts receivable	(89,407 )	(42,427 )
Inventories	(49,782 )	(20,024 )
Prepaid expenses and other assets	(1,255 )	(1,876 )
Accounts payable and other liabilities	6,710	18,679
Net cash provided by operating activities	5,201	61,134
Cash flows from investing activities:		
Capital expenditures	(29,483 )	(25,783 )
Proceeds from sale of property, plant, and equipment	286	2,805

Net cash used in investing activities	(29,197 )	(22,978 )
Cash flows from financing activities:		
Payments on Term Loan (See Note 4)	(102,364)	(2,627 )
Repurchases of common stock	(44,090 )	--
Income tax benefit from exercised stock options	8,973	11,374
Proceeds from exercised stock options	8,765	5,087
Net cash (used in) provided by financing activities	(128,716)	13,834
Net (decrease) increase in cash and cash equivalents	(152,712)	51,990
Cash and cash equivalents, beginning of period	335,041	162,349
Cash and cash equivalents, end of period	\$ 182,329	\$ 214,339

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.  
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
(dollars in thousands)  
(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 (1,298,795 shares)	13	8,752	--	--	8,765
Income tax benefit from exercised stock options	--	8,973	--	--	8,973
Restricted stock activity	1	(1 )	--	--	--
Stock-based compensation expense	--	4,715	--	--	4,715
Issuance of common stock (26,147 shares)	--	850	--	--	850
Repurchases of common stock (1,837,450 shares)	(18 )	(44,072 )	--	--	(44,090 )
Comprehensive income:					
Net income	--	--	--	111,578	111,578
Unrealized gain on interest rate swap agreements, net of tax of \$379	--	--	688	--	688
Total comprehensive income	--	--	688	111,578	112,266
Balance at October 2, 2010	\$ 577	\$ 214,547	\$ (3,378 )	\$ 435,757	\$ 647,503

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 brand names. Our products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic retailers, including the mass channel, and for our 297 Carter's and 177 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 October 2, 2010 and October 3, 2009, the results of our operations for the three and nine-month periods ended October 2, 2010 and October 3, 2009, cash flows for the nine-month periods ended October 2, 2010 and October 3, 2009 and changes in stockholders' equity for the nine-month period ended October 2, 2010. Operating results for the three and nine-month periods ended October 2, 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 third quarter and first nine months of fiscal 2010 reflect our financial position as of October 2, 2010. The third quarter and first nine months of fiscal 2009 ended on October 3, 2009.

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

NOTE 3 – COMPREHENSIVE INCOME:

Comprehensive income is summarized as follows:

	For the three-month periods ended		For the nine-month periods ended	
(dollars in thousands)	October 2,	October 3,	October 2, 2010	October 3,

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	2010	2009	2009	2009
Net income	\$ 49,657	\$ 49,406	\$ 111,578	\$ 82,644
Unrealized gain on interest rate swap agreements, net of tax of \$107, \$93, \$379, and \$91, respectively	225	159	688	156
Settlement of interest rate collar agreement, net of tax of \$216	--	--	--	407
Total comprehensive income	\$ 49,882	\$ 49,565	\$ 112,266	\$ 83,207

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)	October 2, 2010	January 2, 2010	October 3, 2009
Term Loan	\$ 232,159	\$ 334,523	\$ 335,399
Current maturities	(2,450 )	(3,503 )	(3,503 )
Total long-term debt	\$ 229,709	\$ 331,020	\$ 331,896

The Company's senior credit facility is comprised of a \$232.2 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, exclusive of approximately \$8.6 million of outstanding letters of credit at October 2, 2010, January 2, 2010, and October 3, 2009, 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 October 2, 2010, January 2, 2010, and October 3, 2009 were 1.8%, 1.7%, and 1.8% 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 expensed \$0.5 million of debt issuance costs related to the prepayment of a portion of our Term Loan debt.

On October 15, 2010, the Company entered into a new revolving credit facility and paid off the Term Loan. See Note 15 for additional detail.

## NOTE 5 –GOODWILL AND OTHER INTANGIBLE ASSETS:

Goodwill as of October 2, 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:

(dollars in thousands)	Weighted-average useful life	October 2, 2010			January 2, 2010		
		Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount

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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	\$ 19,100	\$ --	\$ 19,100	\$ 17,323	\$ 1,777

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

## NOTE 5 – GOODWILL AND OTHER INTANGIBLE ASSETS: (Continued)

(dollars in thousands)	Weighted-average useful life	Gross amount	October 3, 2009 Accumulated amortization	Net amount
Carter's goodwill (1)	Indefinite	\$ 136,570	\$ --	\$ 136,570
Carter's tradename	Indefinite	\$ 220,233	\$ --	\$ 220,233
OshKosh tradename	Indefinite	\$ 85,500	\$ --	\$ 85,500
OshKosh licensing agreements	4.7 years	\$ 19,100	\$ 16,503	\$ 2,597

(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 \$0.2 million for the three-month period ended October 2, 2010 and \$0.9 million for the three-month period ended October 3, 2009. Amortization expense for intangible assets was approximately \$1.8 million and \$2.9 million for the nine-month periods ended October 2, 2010 and October 3, 2009, respectively.

## 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 nine months of fiscal 2010, we reversed approximately \$0.5 million of reserves for which the statute of limitations expired in the third quarter of fiscal 2010. During the first nine months of fiscal 2009, we reversed 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.

As of October 2, 2010, the Company had gross unrecognized tax benefits of approximately \$8.3 million. Substantially all of the Company's reserve for unrecognized tax benefits as of October 2, 2010, if ultimately recognized, will impact the Company's effective tax rate in the period settled, net of applicable federal income tax affect. 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 October 2, 2010, are approximately \$1.6 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 may impact our annual effective tax rate for fiscal 2011 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 \$0.6 million of interest accrued as of October 2, 2010 and January 2, 2010. As of October 3, 2009, the Company had approximately \$0.5 million of interest accrued.

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

## 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:

1	Level- Quoted prices in active markets for identical assets or liabilities
2	- Quoted prices for similar assets Level and liabilities in active markets or inputs that are observable
3	- Inputs that are unobservable Level (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)	October 2, 2010			January 2, 2010			October 3, 2009		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
<b>Assets</b>									
Investments	\$ 150.4	\$ 13.0	\$ --	\$ --	\$ 130.0	\$ --	\$ --	\$ 190.0	\$ --
Interest rate swaps	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ --	\$ 0.1	\$ --
<b>Liabilities</b>									
Interest rate swaps	\$ --	\$ 0.3	\$ --	\$ --	\$ 1.3	\$ --	\$ --	\$ 1.9	\$ --

At October 2, 2010, we had approximately \$110.4 million invested in money market deposit accounts, \$40.0 million in U.S. Treasury Bills, and \$13.0 million invested in a Black Rock Treasury fund, which invests only in U.S. Treasury Bills and U.S. Government securities.

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.

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.

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 October 2, 2010, approximately \$100.0 million of our \$232.2 million of outstanding debt was hedged under interest rate swap agreements. These interest rate swap agreements mature 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. As of October 3, 2009, approximately \$243.0 million of our \$335.4 million of outstanding debt was hedged under interest rate swap agreements. As of October 2, 2010, we continue to be in compliance with the 25% hedging requirement under our senior credit facility.

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

NOTE 7 – FAIR VALUE MEASUREMENTS: (Continued)

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
October 2, 2010	Prepaid expenses and other current assets	\$ --	Other current liabilities	\$ 0.3
January 2, 2010	Prepaid expenses and other current assets	\$ --	Other current liabilities	\$ 1.3
October 3, 2009	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 was as follows:

	For the three-month period ended October 2, 2010		For the nine-month period ended October 2, 2010	
	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
(dollars in thousands)				

Interest rate hedge agreements	\$ 225	\$ (291 )	\$ 688	\$ (1,440 )
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(1) Amount recognized in accumulated other comprehensive income (loss), net of tax of \$107,000 and \$379,000 for the three and nine-month periods ended October 2, 2010, respectively.

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

## NOTE 7 – FAIR VALUE MEASUREMENTS: (Continued)

	For the three-month period ended October 3, 2009		For the nine-month period ended October 3, 2009	
	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
(dollars in thousands)				
Interest rate hedge agreements	\$ 159	\$ (720 )	\$ 156	\$ (2,134)

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

## 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 nine-month periods ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
(dollars in thousands)				
	\$ 23	\$ 23	\$ 69	\$ 69

Service cost – benefits attributed to service during the period				
Interest cost on accumulated post-retirement benefit obligation	133	113	399	339
Amortization net actuarial gain	(7 )	(7 )	(21 )	(21 )
Total net periodic post-retirement benefit cost	\$ 149	\$ 129	\$ 447	\$ 387

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 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
(dollars in thousands)				
Interest cost on accumulated pension benefit obligation	\$ 12	\$ 12	\$ 36	\$ 38

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

## NOTE 8 – EMPLOYEE BENEFIT PLANS: (Continued)

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 three-month periods ended		For the nine-month periods ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
(dollars in thousands)				
Interest cost on accumulated pension benefit obligation	\$ 598	\$ 567	\$ 1,794	\$ 1,702
Expected return on assets	(718 )	(651 )	(2,156)	(1,951)
Amortization of actuarial loss	34	103	101	308
Total net periodic pension (benefit) expense	\$ (86 )	\$ 19	\$ (261 )	\$ 59

## NOTE 9 – COMMON STOCK:

During the first nine months of fiscal 2010, the Company issued 24,032 and 2,115 shares of common stock at a fair market value of \$33.29 and \$23.65 per share, respectively, to its non-management board members. In connection with these issuances, we recognized approximately \$850,000 in stock-based compensation expense. 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 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 nine-month periods ended October 3, 2009 pursuant to the Company's share repurchase authorization. As of January 2, 2010, approximately \$8.9 million was still remaining under the February 16, 2007 authorization.

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 an additional \$100 million of its outstanding common shares.

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.



During the first nine months of fiscal 2010, beginning in the third quarter, the Company repurchased and retired 1,837,450 shares of its common stock at an average price of \$24.00 per share, leaving approximately \$64.8 million available for repurchase under these authorizations as of October 2, 2010. 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.

CARTER'S, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
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NOTE 10 – STOCK-BASED COMPENSATION:

Under the Company's 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 2, 2010.

Assumptions

Volatility	34.58	%
Risk-free interest rate	3.03	%
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.

The following table summarizes our stock option and restricted stock activity during the nine-month period ended October 2, 2010:

	Time-based stock options	Restricted stock
Outstanding, January 2, 2010	3,512,385	449,844
Granted	414,500	190,733
Exercised	(1,298,795)	--
Vested restricted stock	--	(95,189 )
Forfeited	(105,600 )	(39,400 )
Expired	(17,800 )	--
Outstanding, October 2,	2,504,690	505,988

2010

Exercisable,  
October 2,

2010 1,528,265 --

During the three-month period ended October 2, 2010, we granted 20,000 time-based stock options with a weighted-average Black-Scholes fair value of \$9.14 per share and a weighted-average exercise price of \$23.12 per share. In connection with this grant, we recognized approximately \$6,000 in stock-based compensation expense during the three-month period ended October 2, 2010.

During the nine-month period ended October 2, 2010, we granted 414,500 time-based stock options with a weighted-average Black-Scholes fair value of \$11.80 per share and a weighted-average exercise price of \$27.92 per share. In connection with these grants, we recognized approximately \$680,000 in stock-based compensation expense during the nine-month period ended October 2, 2010.

During the three-month period ended October 2, 2010, we granted 14,229 shares of restricted stock to employees and a director with a weighted-average fair value on the date of grant of \$23.28 per share. In connection with these grants, we recognized approximately \$12,000 in stock-based compensation expense during the three-month period ended October 2, 2010.

During the nine-month period ended October 2, 2010, we granted 190,733 shares of restricted stock to employees and directors with a weighted-average fair value on the date of grant of \$27.89 per share. In connection with these grants, we recognized approximately \$730,000 in stock-based compensation expense during the nine-month period ended October 2, 2010.

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

NOTE 10 – STOCK-BASED COMPENSATION: (Continued)

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 October 3 through January 1, 2011)	\$752	\$865	\$1,617
2011	2,722	3,133	5,855
2012	2,113	2,424	4,537
2013	1,283	1,403	2,686
Total	\$6,870	\$7,825	\$14,695

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:

	For the three-month periods ended				For the nine-month periods ended			
	October		October		October 2,		October 3,	
(dollars in thousands)	2,	% of	3,	% of	2010	% of	2009	% of
	2010	Total	2009	Total		Total		Total
Net sales:								
Carter's:								
Wholesale	\$ 186,396	36.0 %	\$ 165,672	34.4 %	\$ 443,902	35.4 %	\$ 395,550	34.0 %
Retail (a)	150,838	29.1 %	137,708	28.6 %	382,570	30.5 %	349,765	30.0 %
Mass Channel	75,050	14.5 %	78,584	16.3 %	181,808	14.5 %	181,690	15.6 %
Carter's total net sales	412,284	79.6 %	381,964	79.3 %	1,008,280	80.4 %	927,005	79.6 %
OshKosh:								
Retail (a)	77,946	15.0 %	74,103	15.4 %	185,050	14.8 %	178,091	15.3 %
Wholesale	27,698	5.4 %	25,439	5.3 %	60,656	4.8 %	59,901	5.1 %
OshKosh total net sales	105,644	20.4 %	99,542	20.7 %	245,706	19.6 %	237,992	20.4 %
Total net sales	\$517,928	100.0 %	\$481,506	100.0 %	\$1,253,986	100.0 %	\$1,164,997	100.0 %
Operating income (loss):		% of segment net sales		% of segment net sales		% of segment net sales		% of segment net sales
Carter's:								
Wholesale	\$39,843	21.4 %	\$37,698	22.8 %	\$103,482	23.3 %	\$81,122	20.5 %
Retail (a)	31,579	20.9 %	31,381	22.8 %	76,405	20.0 %	64,544	18.5 %
Mass Channel	8,356	11.1 %	13,738	17.5 %	28,006	15.4 %	30,557	16.8 %
	79,778	19.4 %	82,817	21.7 %	207,893	20.6 %	176,223	19.0 %

Carter's operating income										
OshKosh:										
Retail (a)	9,420	12.1 %	10,765	14.5 %	10,475	5.7 %	11,220	6.3 %		
Wholesale	4,955	17.9 %	4,124	16.2 %	6,185	10.2 %	3,607	6.0 %		
Mass Channel (b)	764	--	709	--	2,003	--	1,853	--		
OshKosh operating income										
	15,139	14.3 %	15,598	15.7 %	18,663	7.6 %	16,680	7.0 %		
Segment operating income										
	94,917	18.3 %	98,415	20.4 %	226,556	18.1 %	192,903	16.6 %		
Corporate expense (c)										
	(15,039 )	(2.9 %)	(17,439 )	(3.6 %)	(42,086 )	(3.4 %)	(41,269 )	(3.5 %)		
Workforce reduction and facility  write-down and closure costs (d)										
	--	--	--	--	--	--	(12,365 )	(1.1 %)		
Net corporate expenses										
	(15,039 )	(2.9 %)	(17,439 )	(3.6 %)	(42,086 )	(3.4 %)	(53,634 )	(4.6 %)		
Total operating income										
	\$79,878	15.4 %	\$80,976	16.8 %	\$184,470	14.7 %	\$139,269	12.0 %		

(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.

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

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, 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, 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 )
Balance at April 3,	1,500

2010	
Provision	--
Payments	(600 )
Balance at	
July 3,	
2010	900
Provision	--
Adjustment	(300 )
Payments	(300 )
Balance at	
October 2,	
2010	\$ 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.



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

NOTE 12 – WORKFORCE REDUCTION AND FACILITY CLOSURE COSTS: (Continued)

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.

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
Provision	--	--	--

Adjustment	(50 )	--	(50 )
Payments	--	--	--
Balance at October 2, 2010	\$ --	\$ 450	\$ 450

#### 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 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.

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

## 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 nine-month periods ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Weighted-average number of common and common equivalent shares outstanding:				
Basic number of common shares outstanding	58,325,162	56,825,229	58,513,228	56,334,860
Dilutive effect of unvested restricted stock	89,931	112,370	111,110	116,483
Dilutive effect of stock options	599,598	1,622,531	781,849	1,684,897
Diluted number of common and common equivalent shares outstanding	59,014,691	58,560,130	59,406,187	58,136,240
Basic net income per common share:				
Net income	\$ 49,657,000	\$ 49,406,000	\$ 111,578,000	\$ 82,644,000
Income allocated to participating securities	(427,084 )	(411,426 )	(956,589 )	(694,154 )
Net income available to common shareholders	\$ 49,229,916	\$ 48,994,574	\$ 110,621,411	\$ 81,949,846
Basic net income per common share	\$ 0.84	\$ 0.86	\$ 1.89	\$ 1.45
Diluted net income per common share:				
Net income	\$ 49,657,000	\$ 49,406,000	\$ 111,578,000	\$ 82,644,000
Income allocated to participating securities	(422,775 )	(400,097 )	(944,082 )	(674,160 )
Net income available to common shareholders	\$ 49,234,225	\$ 49,005,903	\$ 110,633,918	\$ 81,969,840
	\$ 0.83	\$ 0.84	\$ 1.86	\$ 1.41

**Diluted net income per  
common share**

For the three and nine-month periods ended October 2, 2010, anti-dilutive shares of 673,804 and 601,404, respectively, were excluded from the computations of diluted earnings per share. 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.

**NOTE 14 – RECENT ACCOUNTING PRONOUNCEMENTS:**

In January 2010, the Financial Accounting Standards Board issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance became effective for the Company with the reporting period beginning January 3, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for the Company with the reporting period beginning January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance will not have a material impact on the Company's unaudited condensed consolidated financial statements.

In February 2010, new accounting guidance was issued related to subsequent events. This guidance amended guidance previously issued in May 2009 regarding subsequent events and states that an entity that is a SEC filer is no longer required to disclose the date through which subsequent events have been evaluated. The adoption of this guidance did not have a material impact on the Company's unaudited condensed consolidated financial statements.

CARTER'S, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
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NOTE 15 – SUBSEQUENT EVENTS:

On October 15, 2010, the Company entered into a new five year \$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, N.A., as sole lead arranger and administrative agent, JP Morgan Chase, and certain other financial institutions. The new revolving credit facility was immediately drawn upon to pay off the Company's existing 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 Term Loan, in the fourth quarter of fiscal 2010, the Company expects to write off approximately \$1.2 million in unamortized debt issuance costs.

## 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 2010 reflect our financial position as of October 2, 2010. The third quarter and first nine months of fiscal 2009 ended on October 3, 2009.

### RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated (i) selected statement of operations data expressed as a percentage of 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 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Wholesale sales:				
Carter's	36.0 %	34.4 %	35.4 %	34.0 %
OshKosh	5.4	5.3	4.8	5.1
Total wholesale sales	41.4	39.7	40.2	39.1
Retail store sales:				
Carter's	29.1	28.6	30.5	30.0
OshKosh	15.0	15.4	14.8	15.3
Total retail store sales	44.1	44.0	45.3	45.3
Mass channel sales	14.5	16.3	14.5	15.6
Consolidated net sales	100.0	100.0	100.0	100.0
Cost of goods sold	62.8	61.5	60.9	62.4
Gross profit	37.2	38.5	39.1	37.6
Selling, general, and administrative expenses	23.8	23.9	26.6	27.0
Workforce reduction and facility write-down and closure costs	--	--	--	0.9

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Royalty income	(2.0 )	(2.2 )	(2.2 )	(2.3 )
Operating income	15.4	16.8	14.7	12.0
Interest expense, net	0.3	0.5	0.5	0.8
Income before income taxes	15.1	16.3	14.2	11.2
Provision for income taxes	5.5	6.0	5.3	4.1
Net income	9.6 %	10.3 %	8.9 %	7.1 %
Number of retail stores at end of period:				
Carter's	297	273	297	273
OshKosh	177	169	177	169
Total	474	442	474	442

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

Three and nine-month periods ended October 2, 2010 compared to the three and nine-month periods ended October 3, 2009

## CONSOLIDATED NET SALES

In the third quarter of fiscal 2010, consolidated net sales increased \$36.4 million, or 7.6%, to \$517.9 million. The increase reflects growth in our Carter's and OshKosh brand wholesale and retail store segments, partially offset by a decline in our Carter's brand mass channel segment. In the first nine months of fiscal 2010, consolidated net sales increased \$89.0 million, or 7.6%, to \$1.3 billion and reflect growth in all channels.

(dollars in thousands)	For the three-month periods ended				For the nine-month periods ended			
	October 2, 2010	% of Total	October 3, 2009	% of Total	October 2, 2010	% of Total	October 3, 2009	% of Total
Net sales:								
Wholesale-Carter's	\$186,396	36.0 %	\$165,672	34.4 %	\$443,902	35.4 %	\$395,550	34.0 %
Wholesale-OshKosh	27,698	5.4 %	25,439	5.3 %	60,656	4.8 %	59,901	5.1 %
Retail-Carter's	150,838	29.1 %	137,708	28.6 %	382,570	30.5 %	349,765	30.0 %
Retail-OshKosh	77,946	15.0 %	74,103	15.4 %	185,050	14.8 %	178,091	15.3 %
Mass Channel-Carter's	75,050	14.5 %	78,584	16.3 %	181,808	14.5 %	181,690	15.6 %
Total net sales	\$517,928	100.0 %	\$481,506	100.0 %	\$1,253,986	100.0 %	\$1,164,997	100.0 %

## CARTER'S WHOLESALE SALES

Carter's brand wholesale sales increased \$20.7 million, or 12.5%, in the third quarter of fiscal 2010 to \$186.4 million. The increase in Carter's brand wholesale sales was driven primarily by a 14% increase in units shipped, partially offset by a 1% decrease in average price per unit, as compared to the third quarter of fiscal 2009.

Carter's brand wholesale sales increased \$48.4 million, or 12.2%, in the first nine months of fiscal 2010 to \$443.9 million. The increase in Carter's brand wholesale sales was driven primarily by a 10% increase in units shipped and a 2% increase in average price per unit, as compared to the first nine months of fiscal 2009.

The increase in units shipped during the third quarter and first nine months of fiscal 2010 was driven by strong over-the-counter performance at our wholesale customers particularly in the baby business, as compared to the third quarter and first nine months of fiscal 2009.

## OSHKOSH WHOLESALE SALES

OshKosh brand wholesale sales increased \$2.3 million, or 8.9%, in the third quarter of fiscal 2010 to \$27.7 million. The increase in OshKosh brand wholesale sales reflects an 11% increase in units shipped, partially offset by a 2% decrease in average price per unit, as compared to the third quarter of fiscal 2009. The increase in units shipped was largely due to the timing of 2010 shipments.



OshKosh brand wholesale sales increased \$0.8 million, or 1.3%, in the first nine months of fiscal 2010 to \$60.7 million. The increase in OshKosh brand wholesale sales reflects a 3% increase in average price per unit, partially offset by a 2% decrease in units shipped as compared to the first nine months of fiscal 2009. The increase in average price per unit primarily reflects higher average selling prices on off-price sales compared to the first nine months of fiscal 2009. The decrease in units shipped primarily reflects lower levels of off-price shipments.

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

MASS CHANNEL SALES

Mass channel sales decreased \$3.5 million, or 4.5%, in the third quarter of fiscal 2010 to \$75.1 million. The decrease reflects a \$5.4 million, or 11.9%, decrease in sales of our Child of Mine brand to Walmart, partially offset by a \$1.8 million, or 5.5%, increase in sales of our Just One You (formerly Just One Year) brand to Target. Mass channel sales increased \$0.1 million, or 0.1%, in the first nine months of fiscal 2010 to \$181.8 million. The increase was driven by a \$13.0 million, or 15.7%, increase in sales of our Just One You brand to Target, almost entirely offset by a \$12.9 million, or 13.0%, decrease in sales of our Child of Mine brand.

The increases in both periods in Just One You brand sales were driven largely by the addition of new programs, including Precious Firsts, along with increased volume on the brandwall and seasonal hanging programs. The decreases in both periods in Child of Mine brand sales resulted from merchandising assortment changes made by Walmart and a related reduction in floor space. In addition, during the third quarter and first nine months of fiscal 2010, the reduction in floor space at Walmart was partially offset by favorable timing of shipments resulting from earlier than planned demand.

CARTER'S RETAIL STORES

Carter's retail store sales increased \$13.1 million, or 9.5%, in the third quarter of fiscal 2010 to \$150.8 million. The increase was driven by incremental sales of \$11.9 million generated by new store openings and eCommerce sales and a comparable store sales increase of 1.4%, or \$2.0 million, partially offset by the impact of store closings and relocations of approximately \$0.8 million. On a comparable store basis, units per transaction increased 3.8%, transactions increased 2.3%, and average prices decreased 4.5%, as compared to the third quarter of fiscal 2009 primarily due to increased promotional activity. In addition, year-over-year average inventory per door was down 3.0%.

Carter's retail store sales increased \$32.8 million, or 9.4%, in the first nine months of fiscal 2010 to \$382.6 million. The increase was driven by incremental sales of \$28.6 million generated by new store openings and eCommerce sales, a comparable store sales increase of 1.6%, or \$5.5 million, partially offset by the impact of store closings and relocations of approximately \$1.4 million. On a comparable store basis, units per transaction increased 2.4%, average transaction value increased 1.4%, and average prices decreased 0.9%, as compared to the first nine months of fiscal 2009. The increases in units per transaction and average transaction value were driven by strong product performance in our playwear product category, improved in-store product presentation, and increased merchandising and marketing efforts. The decrease in average prices was due to increased promotional activity given the current competitive environment.

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 will 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, such 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.

During the third quarter of fiscal 2010, the Company opened eight Carter's retail stores. During the first nine months of fiscal 2010, the Company opened 21 Carter's retail stores. There were a total of 297 Carter's retail stores as of October 2, 2010. In total, the Company plans to open 30 Carter's retail stores during fiscal 2010.

## OSHKOSH RETAIL STORES

OshKosh retail store sales increased \$3.8 million, or 5.2%, in the third quarter of fiscal 2010 to \$77.9 million. The increase was driven by incremental sales of \$5.4 million generated by new store openings and eCommerce sales, and a comparable store sales increase of 0.6%, or \$0.4 million, partially offset by the impact of store closings and relocations of \$2.1 million. On a comparable store basis, transactions increased 3.5%, units per transaction increased 2.6%, and average prices decreased 5.2%. The increases in transactions and units per transaction were driven by strong product performance. The decrease in average prices is attributed to increased promotional activity given the current competitive environment. In addition, year-over-year average inventory per door was down 4.6%.

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

OshKosh retail store sales increased \$7.0 million, or 3.9%, in the first nine months of fiscal 2010 to \$185.1 million. The increase reflects incremental sales of \$10.3 million generated by new store openings and eCommerce sales, partially offset by the impact of store closings and relocations of \$3.0 million and a comparable store sales decrease of 0.2%, or \$0.2 million. On a comparable store basis, units per transaction increased 3.5%, transactions decreased 0.4%, and average prices decreased 3.1%. The increase in units per transaction was due to strong product performance, in-store product presentation, and direct-to-consumer marketing efforts, partially offset by a decrease in transactions attributable to reduced traffic at our stores.

During the third quarter of fiscal 2010, the Company opened three OshKosh retail stores and closed one OshKosh retail store. During the first nine months of fiscal 2010, the Company opened eight OshKosh retail stores and closed one OshKosh retail store. There were a total of 177 OshKosh retail stores as of October 2, 2010. In total, the Company plans to open 13 and close three OshKosh retail stores during fiscal 2010.

GROSS PROFIT

Gross profit increased \$7.2 million, or 3.9%, to \$192.8 million in the third quarter of fiscal 2010. Gross profit as a percentage of net sales was 37.2% in the third quarter of fiscal 2010 as compared to 38.5% in the third quarter of fiscal 2009. The decrease in gross profit as a percentage of net sales primarily reflects lower Carter's wholesale and mass channel margins largely due to higher in-bound air freight costs on expedited goods of approximately \$6.0 million. Partially offsetting this decrease was a \$1.1 million increase related to higher consolidated retail gross margins as a percentage of consolidated retail sales.

Gross profit increased \$51.9 million, or 11.8%, to \$489.9 million in the first nine months of fiscal 2010. Gross profit as a percentage of net sales was 39.1% in the first nine months of fiscal 2010 as compared to 37.6% in the first nine months of fiscal 2009. The increase in gross profit as a percentage of net sales reflects:

- \$11.7 million related to higher consolidated retail gross margins as a percentage of consolidated retail sales; and
- \$5.8 million related to growth in Carter's wholesale margins due to increased volume and improved product performance.

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.

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

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES

Selling, general, and administrative expenses in the third quarter of fiscal 2010 increased \$8.1 million, or 7.0%, to \$123.3 million. As a percentage of net sales, selling, general, and administrative expenses in the third quarter of fiscal 2010 decreased to 23.8% as compared to 23.9% in the third quarter of fiscal 2009. Selling, general, and administrative expenses in the first nine months of fiscal 2010 increased \$18.9 million, or 6.0%, to \$333.1 million. As a percentage of net sales, selling, general, and administrative expenses in the first nine months of fiscal 2010 decreased to 26.6% as compared to 27.0% in the first nine months of fiscal 2009.

The decreases in selling, general, and administrative expenses as a percentage of net sales reflect:

- a \$0.6 million and \$1.8 million decrease in provisions for performance-based incentives during the third quarter and first nine months of fiscal 2010, respectively; and
- a \$0.7 million and \$1.1 million decrease in amortization expense on our intangible assets as they were fully amortized as of the end of the third quarter of fiscal 2010.

Partially offsetting these decreases were:

- an increase in our consolidated retail expenses from 27.2% and 31.1% of retail store sales in the third quarter and first nine months of fiscal 2009, respectively, to 28.5% and 31.9% in the third quarter and first nine months of fiscal 2010, respectively; and
- \$2.8 million and \$5.4 million of incremental expenses associated with eCommerce for the third quarter and first nine months of fiscal 2010, respectively.

WORKFORCE REDUCTION AND FACILITY CLOSURE COSTS

As a result of the corporate workforce reduction, the Company 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 corporate office during the first nine months of fiscal 2009. The majority of the remaining severance payments will be paid by 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 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.



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

ROYALTY INCOME

We license the use of our Carter's, Just One You (formerly 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 2010 was approximately \$10.4 million (including \$2.4 million of international royalty income), a decrease of \$0.2 million, or 2.3%, as compared to the third quarter of fiscal 2009. The decrease reflects lower Child of Mine brand sales and sales from our OshKosh brand international licensees, partially offset by increased sales by our Carter's international, Just One You, and OshKosh brand domestic licensees.

Royalty income from these brands in the first nine months of fiscal 2010 was approximately \$27.7 million (including \$6.7 million of international royalty income), an increase of 3.0%, or \$0.8 million, as compared to the first nine months of fiscal 2009. The increase was driven by increased sales by our Carter's brand domestic and international licensees and OshKosh brand domestic licensees, partially offset by decreased Child of Mine brand sales and sales from our OshKosh brand international licensees.

OPERATING INCOME

Operating income decreased \$1.1 million, or 1.4%, to \$79.9 million in the third quarter of fiscal 2010. Operating income increased \$45.2 million, or 32.5%, to \$184.5 million in the first nine months of fiscal 2010. The changes in operating income were due to the factors described above.

INTEREST EXPENSE, NET

Interest expense in the third quarter of fiscal 2010 decreased \$1.1 million, or 41.7%, to \$1.6 million. The decrease is primarily attributable to lower weighted-average borrowings and a lower effective interest rate. Weighted-average borrowings in the third quarter of fiscal 2010 were \$232.8 million at an effective interest rate of 2.86% compared to weighted-average borrowings in the third quarter of fiscal 2009 of \$336.2 million at an effective interest rate of 3.23%. In the third quarter of fiscal 2010 and 2009, we recorded \$0.3 million and \$0.7 million, respectively, in interest expense related to our interest rate swap agreements.

Interest expense in the first nine months of fiscal 2010 decreased \$1.9 million, or 22.1%, to \$6.7 million. The decrease is primarily attributable to lower weighted-average borrowings and a lower effective interest rate, partially offset by a \$0.5 million write-off of debt issuance costs related to the prepayment of a portion of our Term Loan debt. Weighted-average borrowings in the first nine months of fiscal 2010 were \$299.2 million at an effective interest rate of 3.18% as compared to weighted-average borrowings in the first nine months of fiscal 2009 of \$337.1 million at an effective interest rate of 3.47%. In the first nine months of fiscal 2010, we recorded \$1.4 million in interest expense related to our interest rate swap agreements. 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. On October 15, 2010, the Company entered into a new revolving credit facility and paid off the Term Loan, see Note 15, Subsequent Events to our accompanying unaudited condensed consolidated financial statements.

INCOME TAXES

Our effective tax rate was 36.6% for the third quarter of fiscal 2010 and 36.9% for the third quarter of fiscal 2009.

Our effective tax rate was 37.2% for the first nine months of fiscal 2010 and 36.8% for the first nine months of fiscal 2009. This change relates primarily to the reversal of \$1.0 million of reserves for uncertain tax positions related to the completion of an Internal Revenue Service examination for fiscal 2006 in the first nine months of fiscal 2009.



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

NET INCOME

As a result of the factors described above, our net income for the third quarter of fiscal 2010 increased \$0.3 million, or 0.5%, to \$49.7 million as compared to \$49.4 million in the third quarter of fiscal 2009. Our net income for the first nine months of fiscal 2010 increased \$28.9 million, or 35.0%, to \$111.6 million from \$82.6 million in the first nine months of fiscal 2009.

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 the availability of 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 Part II, Item 1A of this filing.

Net accounts receivable at October 2, 2010 were \$171.5 million compared to \$127.9 million at October 3, 2009 and \$82.1 million at January 2, 2010. The increase as compared to October 3, 2009 primarily reflects increased wholesale sales in the latter part of the third quarter of fiscal 2010 as compared to the third quarter of fiscal 2009. Due to the seasonal nature of our operations, the net accounts receivable balance at October 2, 2010 is not comparable to the net accounts receivable balance at January 2, 2010.

Net inventories at October 2, 2010 were \$263.8 million compared to \$223.5 million at October 3, 2009 and \$214.0 million at January 2, 2010. The increase of \$40.3 million, or 18.0%, as compared to October 3, 2009 is primarily to support future demand in all of our businesses, increased product costs, and incremental eCommerce inventory. Due to the seasonal nature of our operations, net inventories at October 2, 2010 are not comparable to net inventories at January 2, 2010.

Net cash provided by operating activities for the first nine months of fiscal 2010 was \$5.2 million compared to net cash provided by operating activities of \$61.1 million in the first nine months of fiscal 2009. The decrease in operating cash flow primarily reflects changes in net working capital partially offset by increased earnings.

We invested \$29.5 million in capital expenditures during the first nine months of fiscal 2010 compared to \$25.8 million during the first nine months of fiscal 2009. We plan to invest approximately \$40 million in capital expenditures during fiscal 2010, primarily for retail store openings and remodelings and fixtures for our wholesale customers.

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 nine-month periods ended October 3, 2009 pursuant to the Company's share repurchase authorization. As of January 2, 2010, approximately \$8.9 million was still remaining under the February 16, 2007 authorization.

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 an additional \$100 million of its outstanding common shares.

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.

During the first nine months of fiscal 2010, beginning in the third quarter, the Company repurchased and retired 1,837,450 shares of its common stock at an average price of \$24.00 per share. Since inception of the authorization and through October 2, 2010, the Company repurchased and retired 6,437,030 shares of its common stock at an average price of \$21.00 per share, leaving approximately \$64.8 million available for repurchase under these authorizations as of October 2, 2010. 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.

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

During the second quarter of fiscal 2010, the Company repaid \$100 million in Term Loan borrowings, in addition to a regularly scheduled amortization payment of approximately \$0.9 million.

As of October 2, 2010, we had approximately \$232.2 million in Term Loan borrowings and no borrowings outstanding under our revolver, 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 \$0.6 million through June 30, 2012 with the remaining balance of \$227.9 million due on July 14, 2012. Weighted-average borrowings in first nine months of fiscal 2010 were \$299.2 million at an effective interest rate of 3.18% as compared to weighted-average borrowings in the first nine months of fiscal 2009 of \$337.1 million at an effective interest rate of 3.47%.

The senior credit facility contains and defines financial covenants, including a minimum interest coverage ratio of 4.00 to 1.00, maximum leverage ratio of 3.00 to 1.00, and a minimum fixed charge coverage ratio of 2.00 to 1.00, as of October 2, 2010. The Company's actual interest coverage ratio, leverage ratio, and fixed charge coverage ratio as of October 2, 2010 are 33.07 to 1.00, 0.84 to 1.00, and 13.37 to 1.00, respectively. As of October 2, 2010, the Company believes it was in compliance with its debt covenants.

Our senior credit facility requires us to hedge at least 25% of our variable rate debt under this facility using interest rate swaps or other similar instruments. As of October 2, 2010, \$100.0 million, or 43.1%, of our senior credit facility borrowings were subject to interest rate swap agreements.

On October 15, 2010, the Company entered into a new \$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, N.A., as sole lead arranger and administrative agent, JP Morgan Chase, and certain other financial institutions. The new revolving credit facility was immediately drawn upon to pay off the Company's existing 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 Term Loan, in the fourth quarter of fiscal 2010 the Company expects to write off approximately \$1.2 million in unamortized debt issuance costs.

The term of the new revolving credit facility expires October 15, 2015. This revolving credit facility provides for two pricing options for 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  $\frac{1}{2}$  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 1.25%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.00% to 1.50% 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 2.25%, which may be adjusted based upon a leverage-based pricing grid ranging from 2.00% to 2.50%. Amounts currently outstanding under the revolving credit facility initially accrue interest at a LIBOR rate plus 2.25%.

The new 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, 2014, 3.75:1.00 and (y) if such period ends after December 31, 2014, 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 2.75:1.00.

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.

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

### EFFECTS OF INFLATION AND DEFLATION; OPERATING COSTS

In recent years, there has been deflationary pressure on selling prices. If deflationary price trends outpace our ability to offset our rising manufacturing and supply chain costs, or our ability to otherwise lower our overall cost structure, our profitability will be adversely affected. We are also anticipating appreciation in Asian currencies. All of these increases and currency appreciation would impact our cost of goods sold and inventory levels. We do not expect to be able to fully absorb these price increases by reducing our manufacturing or supply chain costs or by lowering our overall cost structure; and if we are unable to effectively raise prices, our profitability will be significantly impacted.

### SEASONALITY

We experience seasonal fluctuations in our sales and profitability due to the timing of certain holidays and key retail shopping periods, generally resulting in lower sales and gross profit in the first half of our fiscal year. Excluding the impact of the acquisition of OshKosh B'Gosh, Inc. in fiscal 2005, our consolidated net sales over the past five fiscal years has typically been generated in the second half of our fiscal year (approximately 57%). Accordingly, our results of operations during the first half of the year may not be indicative of the results we expect for the full 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.

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements contained in our most recently filed Annual Report on Form 10-K. 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 estimated 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.

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

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. In accordance with accounting guidance on consideration given by a vendor to a customer/reseller, we have included the fair value of these arrangements of approximately \$0.7 million and \$2.4 million in the third quarter and first nine months of fiscal 2010, respectively, and \$1.0 million and \$1.9 million in the third quarter and first nine months of fiscal 2009, respectively, as a component of selling, general, and administrative expenses on the accompanying audited consolidated statement 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.

**Goodwill and tradename:** As of October 2, 2010, we had approximately \$136.6 million in Carter's goodwill 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 using a discounted cash flow analysis at the time of the acquisition of Carter's, Inc. which was consummated on August 15, 2001. The particular discounted cash flow approach utilized 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 Carter's and OshKosh tradenames were determined to have indefinite lives.

The carrying values of the goodwill and tradename assets are subject to annual impairment reviews in accordance with accounting guidance on goodwill and other intangible assets, as of the last day of each fiscal year. Impairment reviews may also be triggered by any significant events or changes in circumstances affecting our business. Factors affecting such impairment reviews include the continued market acceptance of our offered products and the development of new products. We use discounted cash flow models to determine the fair value of these assets, using assumptions we believe hypothetical marketplace participants would use. For indefinite-lived intangible assets, if the carrying amount exceeds the fair value, an impairment charge is recognized in the amount equal to that excess.

We perform impairment tests of our goodwill at our reporting unit level, which is consistent with our operating segments. The goodwill impairment test consists of a two-step process, if necessary. The first step is to compare the fair value of a reporting unit to its carrying value, including goodwill. We use discounted cash flow models to determine the fair value of a reporting unit. The assumptions used in these models are consistent with those we believe hypothetical marketplace participants would use. If the fair value of a reporting unit is less than its carrying value, the second step of the impairment test must be performed in order to determine the amount of impairment loss, if any. The second step compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds its implied fair value, an impairment charge is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of goodwill.

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

A deterioration of macroeconomic conditions may not only negatively impact the estimated operating cash flows used in our cash flow models, but may also negatively impact other assumptions used in our analyses, including, but not limited to, the estimated cost of capital and/or discount rates. Additionally, as discussed above, in accordance with accounting guidance, we are required to ensure that assumptions used to determine fair value in our analyses are consistent with the assumptions a hypothetical marketplace participant would use. As a result, the cost of capital and/or discount rates used in our analyses may increase or decrease based on market conditions and trends, regardless of whether our actual cost of capital has changed. Therefore, we may recognize an impairment of an intangible asset or assets even though realized actual cash flows are approximately equal to or greater than our previously forecasted amounts.

**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.

**Loss contingencies:** We record accruals for various contingencies including legal exposures as they arise in the normal course of business. In accordance with accounting guidance on contingencies, 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 contribution plan, a frozen defined benefit pension plan and other unfunded post-retirement plans. The defined benefit pension and post-retirement plans require an actuarial valuation to determine plan obligations and related periodic costs. We use independent actuaries to assist with these



calculations. Plan valuations require economic assumptions, including expected rates of return on plan assets, discount rates to value plan obligations, employee demographic assumptions including mortality rates, and changes in health care costs. The actuarial assumptions used may differ materially from actual results due to changing market and economic conditions. Actual results that differ from the actuarial assumptions are reflected as unrecognized gains and losses. Unrecognized gains and losses that exceed 10% of the greater of the plan's projected benefit obligations or market value of assets are amortized to earnings over the estimated service life of the remaining plan participants.

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

Significant assumptions used in valuing our net obligation under our Oshkosh B'Gosh pension plan under which retirement benefits were frozen as of December 31, 2005 are expected long-term rates of return on plans assets and the discount rate used to determine the plan's projected benefit obligation.

The most significant assumption used to determine our projected benefit obligation under our post-retirement life and medical plan under which retirement benefits were frozen in 1991 is the discount rate used to determine the plan's projected benefit obligation.

See Note 7, "Employee Benefits Plans," to our audited consolidated financial statements in our most recently filed Annual Report on Form 10-K for further details on rates, assumptions, and sensitivity analyses.

**Stock-based compensation arrangements:** We account for stock-based compensation in accordance with the fair value recognition provisions of accounting guidance on share-based payments. We adopted this guidance using the modified prospective application method of transition. We use 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. We use actual monthly historical changes in the market value of our stock covering the expected life of stock options being valued. An increase in the expected volatility will increase compensation expense.

**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.

**Dividend yield** – We do not have plans to pay dividends in the foreseeable future. An increase in the dividend yield will decrease compensation expense.

**Forfeitures** – We estimate 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 audited consolidated statement of operations.

We account for our performance-based awards in accordance with accounting guidance on share-based payments and record stock-based compensation expense 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. We reassess the probability of vesting at each reporting period for awards with performance criteria and adjust stock-based compensation expense based on its probability assessment.

**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 2010 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, 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 source products from approximately 100 vendors in over 10 countries, 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 2, 2010, our outstanding debt aggregated approximately \$232.2 million, of which \$132.2 million, or 56.9%, 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 \$1.3 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 our 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

### 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 as of October 2, 2010 due to the fact that there were material weaknesses in our internal control over financial reporting as discussed in more detail in our Annual report on Form 10-K for fiscal 2009 under Part II, Item 9A.

### Remediation Plan

Management has been actively engaged in implementing remediation plans to address control deficiencies referenced above. The following remediation efforts have been completed:

- Making personnel changes, including the separation of certain employees from the Company, and a restructuring of the Company's sales organization;
- Establishing more comprehensive procedures for authorizing accommodations, including tiered accommodations approval levels that include the Chief Financial Officer and Chief Executive Officer;
- 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 a new position in the finance organization with responsibilities to include tracking, monitoring, and reviewing all customer accommodations, including certain budgetary responsibilities for accommodations; and
- Improving the method of educating employees on the Company's Code of Business Ethics and Professional Conduct.

The remediation effort in process and expected to be finalized during the fourth quarter of fiscal 2010 includes 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.

Management has developed a detailed plan and timetable for the implementation of the foregoing remediation efforts and will continue to 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

The completed remediation efforts noted above represent changes in internal control over financial reporting during the quarter ended October 2, 2010 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 County 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 asserted claims under Sections 10(b), 20(a), and 20A of the 1934 Securities Exchange Act, and alleged 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 initial Complaint in the Mylroie Action asserted claims under Sections 10(b) and 20(a) of the 1934 Securities Exchange Act, and alleged 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"). On March 15, 2010, the plaintiffs in the Consolidated Action filed their amended and consolidated complaint. The Company filed a motion to dismiss on April 30, 2010, and briefing of the motion was complete on July 23, 2010. The parties are awaiting an oral argument date and/or a decision from the Court. The Company intends to vigorously defend against the claims in the Consolidated Action.

A shareholder derivative lawsuit was filed on May 25, 2010 in the Superior Court of Fulton County, Georgia, entitled Alvarado v. Bloom, No. 2010-cv-186118 (the "Alvarado Action"). The Complaint in the Alvarado Action alleges, among other things, that certain current and former directors and executives of the Company breached their fiduciary duties to the Company in connection with the Company's accounting for discounts offered to some wholesale customers. The Company is named solely as a nominal defendant against whom the plaintiff seeks no recovery. Pursuant to a series of stipulations among the parties, the Court has temporarily deferred the defendants' obligation to respond to the Complaint pending timely resolution of the motions to dismiss filed in the Consolidated Action referenced above.

The Company is subject to various other claims and pending or threatened lawsuits in the normal course of our business. The Company is not currently party to any other legal proceedings that it believes would have a material adverse effect on its 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 SEC 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 2010, we derived approximately 42% and 41% of our consolidated net sales from our top eight customers, including mass channel customers. Kohl's accounted for approximately 11% and 10% of our consolidated net sales in the third quarter and first nine months of fiscal 2010, respectively. 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 their business with us or terminate 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 and timely evaluate and adapt our products to changes in 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 effect 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, Just One Year, Just One You, Precious Firsts, Child of Mine, OshKosh, OshKosh B'gosh, Genuine Kids, 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 previously filed restatements.

We are currently involved in litigation matters and investigations and may be subject to additional actions in the future. As disclosed in the Company's amended and restated Annual Report on Form 10-K for fiscal 2008, we announced on November 10, 2009, that 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 self-reported information concerning this investigation to the SEC in the fourth quarter of fiscal 2009 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 have diverted in the past, and may continue to divert in the future, 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 it is 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 Part II - Item 1 of this filing, the Company is also currently subject to two class action lawsuits and a derivative shareholder action lawsuit, 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 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.

In part due to the actions of discount retailers, and in part due to the worldwide supply of low cost garment sourcing, the Company continues to experience pressure to decrease selling prices on children's apparel. If deflationary price trends outpace our ability to reduce our manufacturing and supply chain costs, or otherwise lower our overall cost structure, our profitability may be affected.

Increased production costs may adversely affect our results.

We anticipate increases in supply chain costs, such as cotton, labor, and transportation costs. We are also anticipating appreciation in Asian currencies. All of these increases and currency appreciation would impact our cost of goods sold and inventory levels. We do not expect to be able to fully absorb these price increases by reducing our manufacturing or supply chain costs or by lowering our overall cost structure; and if we are unable to effectively raise prices, our profitability will be significantly impacted.

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. Discretionary consumer spending is impacted 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 discretionary spending may have a material adverse effect on the Company's sales and results of operations.



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 or more 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 or significant changes in the relationship between carrier capacity and shipper demand;
- interruptions in the supply, or increases in the cost, of raw materials, including cotton, fabric, and trim items;
- significant changes in the cost of labor in our sourcing locations;
- 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 effect 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 including the Consumer Product Safety Commission, 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, or that of our vendors, 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 Disney, Gymboree, Old Navy, The Children's Place, and The Gap. 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 brand stores do not maintain a sufficient customer base that provides a reasonable sales volume or the Company is unable to

negotiate appropriate lease terms for the retail stores, there could be a material adverse impact on the Company's sales, gross margin, and results of operations.



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 2, 2010, the Company had Carter's goodwill of \$136.6 million, a \$220.2 million Carter's brand tradename asset, and an \$85.5 million OshKosh brand tradename asset on its 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 in internal controls over financial reporting could have a material adverse effect on our business, results of operations, and financial condition.

In connection with our assessment 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 2, 2010, 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 filing for further discussion of the ineffectiveness of, and material weaknesses in, our internal controls over financial reporting. 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 misstatements.

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:

The following table provides information about purchases by the Company during the three-month period ended October 2, 2010, of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (2)	Approximate dollar value of shares that may yet be purchased under the plans or programs (2)
July 4, 2010 through July 31, 2010	--	--	--	\$ 108,895,948
August 1, 2010 through August 28, 2010	831,450	\$23.74	831,450	\$89,159,057
August 29, 2010 through October 2, 2010	1,006,000	\$24.21	1,006,000	\$64,806,211
Total	1,837,450	\$24.00	1,837,450	\$64,806,211

(1) Represents repurchased shares which were retired.

(2) On February 16, 2007, our 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. This program was announced in the Company's report on Form 8-K, which was filed on February 21, 2007. On June 15, 2010, the Company's Board of Directors approved another share repurchase authorization, pursuant to which the Company is authorized to purchase up to an additional \$100 million of its outstanding common shares. This program was announced in the Company's report on Form 8-K, which was filed on July 29, 2010. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. These authorizations have 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. The total remaining authorization was \$64,806,211 as of October 2, 2010.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES:

N/A

## ITEM 4. REMOVED AND RESERVED:

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

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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: October 29, 2010

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

Date: October 29, 2010

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