CARTERS INC
Form 10-Q
August 01, 2011

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 2, 2011 OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number:

001-31829

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

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

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

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes (X) No ( )

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

Large Accelerated Filer (X) Accelerated Filer ( ) Non-Accelerated Filer ( ) Smaller Reporting Company ( )

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ( ) No (X)

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

Common Stock	Outstanding Shares at July 29, 2011
Common stock, par value $0.01 per share	58,063,327

CARTER'S, INC.
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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	July 2, 2011	January 1, 2011	July 3, 2010
ASSETS			
Current assets:			
Cash and cash equivalents	$86,725	$247,382	$245,013
Accounts receivable, net	124,667	121,453	99,526
Finished goods inventories, net	458,114	298,509	260,660
Prepaid expenses and other current assets	16,689	17,372	11,583
Deferred income taxes	23,687	31,547	25,726
Total current assets	709,882	716,263	642,508
Property, plant, and equipment, net	101,796	94,968	90,374
Tradenames	306,356	305,733	305,733
Goodwill	191,050	136,570	136,570
Deferred debt issuance costs, net	2,978	3,332	1,459
Other intangible assets, net	311	--	137
Other assets	445	316	292
Total assets	$1,312,818	$1,257,182	$1,177,073
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Current maturities of long-term debt	$--	$--	$3,503
Accounts payable	119,428	116,481	121,047
Other current liabilities	37,226	66,891	31,848
Total current liabilities	156,654	183,372	156,398
Long-term debt	236,000	236,000	229,269
Deferred income taxes	112,261	113,817	108,162
Other long-term liabilities	75,021	44,057	44,105
Total liabilities	579,936	577,246	537,934
Commitments and contingencies			
Stockholders' equity:			
Preferred stock; par value $.01 per share; 100,000 shares authorized; none issued or outstanding at July 2, 2011, January 1, 2011, and July 3, 2010	--	--	--
	581	575	594

Common stock, voting; par value $.01 per share; 150,000,000 shares authorized; 58,087,327, 57,493,567, and 59,442,933 shares issued and outstanding at July 2, 2011, January 1, 2011, and July 3, 2010, respectively			
Additional paid-in capital	218,857	210,600	256,048
Accumulated other comprehensive loss	(1,989)	(1,890)	(3,603)
Retained earnings	515,433	470,651	386,100
Total stockholders' equity	732,882	679,936	639,139
Total liabilities and stockholders' equity	$1,312,818	$1,257,182	$1,177,073

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 six-month periods ended	
	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Net sales	$394,488	$327,009	$863,488	$736,058
Cost of goods sold	259,750	196,758	570,944	438,997
Gross profit	134,738	130,251	292,544	297,061
Selling, general, and administrative expenses	119,802	104,468	232,266	209,763
Acquisition-related expenses	1,183	--	2,220	--
Royalty income	(8,269)	(7,640)	(17,598)	(17,294)
Operating income	22,022	33,423	75,656	104,592
Interest expense, net	1,756	2,662	3,606	5,106
Foreign exchange gain	(231)	--	(231)	--
Income before income taxes	20,497	30,761	72,281	99,486
Provision for income taxes	7,838	11,665	27,499	37,565
Net income	$12,659	$19,096	$44,782	$61,921
Basic net income per common share (Note 13)	$0.22	$0.32	$0.77	$1.05
Diluted net income per common share (Note 13)	$0.22	$0.32	$0.76	$1.03

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	For the six-month periods ended	
	July 2, 2011	July 3, 2010
Cash flows from operating activities:		
Net income	$44,782	$61,921
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	16,367	16,082
Amortization of debt issuance costs	354	1,010
Non-cash stock-based compensation expense	4,883	3,510
Income tax benefit from exercised stock options	(2,840)	(8,579)
Loss (gain) on disposal/sale of property, plant, and equipment	140	(172)
Deferred income taxes	4,844	5,152
Effect of changes in operating assets and liabilities, excluding the effects from the Acquisition of Bonnie Togs:		
Accounts receivable	(234)	(17,432)
Inventories	(123,324)	(46,660)
Prepaid expenses and other assets	1,291	(456)
Accounts payable and other liabilities	(32,565)	952
Net cash (used in) provided by operating activities	(86,302)	15,328
Cash flows from investing activities:		
Capital expenditures	(16,086)	(20,720)
Acquisition of Bonnie Togs	(61,199)	--
Proceeds from sale of property, plant, and equipment	--	286
Net cash used in investing activities	(77,285)	(20,434)
Cash flows from financing activities:		
Payments on term loan	--	(101,751)
Income tax benefit from exercised stock options	2,840	8,579
Withholdings from vesting of restricted stock	(1,602)	(621)
Proceeds from exercise of stock options	1,692	8,871
Net cash provided by (used in) financing activities	2,930	(84,922)
Net decrease in cash and cash equivalents	(160,657)	(90,028)
Cash and cash equivalents, beginning of period	247,382	335,041
Cash and cash equivalents, end of period	$86,725	$245,013

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Common stock	Additional paid-in capital	Accumulated other comprehensive (loss) income	Retained earnings	Total stockholders' equity
Balance at January 1, 2011	$575	$210,600	$ (1,890)	$470,651	$ 679,936
Exercise of stock options (293,508 shares)	3	1,689	--	--	1,692
Issuance of common stock (38,520 shares)	--	1,170	--	--	1,170
Withholdings from vesting of restricted stock (56,018 shares)	(1)	(1,601)	--	--	(1,602)
Income tax benefit from exercised stock options	--	2,840	--	--	2,840
Restricted stock activity	4	(4)	--	--	--
Stock-based compensation expense	--	4,163	--	--	4,163
Comprehensive income:					
Net income	--	--	--	44,782	44,782
Foreign currency translation adjustments	--	--	(99)	--	(99)
Total comprehensive income	--	--	(99)	44,782	44,683
Balance at July 2, 2011	$581	$218,857	$ (1,989)	$515,433	$ 732,882

See accompanying notes to the unaudited condensed consolidated financial statements.

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

NOTE 1 – THE COMPANY:

Carter's, Inc. and its wholly owned subsidiaries (collectively, the "Company," "we," "us," "its," and "our") design, source, and market branded childrenswear under the Carter's, Child of Mine, Just One You, Precious Firsts, OshKosh, and other brands. Our products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic retailers, including the mass channel, and for our 328 Carter's, 177 OshKosh, 37 Bonnie Togs, and 22 co-branded Carter's and OshKosh retail stores that market our brand name merchandise and other licensed products manufactured by other companies.

On June 30, 2011, Northstar Canadian Operations Corp. ("Northstar"), a newly formed Canadian corporation and a wholly owned subsidiary of The William Carter Company (a wholly owned subsidiary of Carter's, Inc.), purchased all of the outstanding shares of capital stock of the entities comprising Bonnie Togs ("Bonnie Togs"), a Canadian specialty retailer focused exclusively on the children's apparel and accessories marketplace. Bonnie Togs operates 59 retail stores in Canada and sells products under the Carter's and OshKosh B'gosh brands, as well as other private label and national brands. Bonnie Togs was Carter's principal licensee in Canada since 2007 and was the Company's most significant international licensee.

Our condensed consolidated balance sheet as of July 2, 2011 reflects the acquisition of Bonnie Togs. The condensed consolidated statements of operations for the three and six-month periods ended July 2, 2011 were immaterially affected by the acquisition.

NOTE 2 – BASIS OF PREPARATION:

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

In our opinion, the Company's accompanying unaudited condensed consolidated financial statements contain all adjustments necessary for a fair statement of our financial position as of July 2, 2011, the results of our operations for the three and six-month periods ended July 2, 2011 and July 3, 2010, cash flows for the six-month periods ended July 2, 2011 and July 3, 2010 and changes in stockholders' equity for the six-month period ended July 2, 2011. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the three and six-month periods ended July 2, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2011. Our accompanying condensed consolidated balance sheet as of January 1, 2011 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 1, 2011.

Our fiscal year ends on the Saturday, in December or January, nearest the last day of December. The accompanying unaudited condensed consolidated financial statements for the second quarter and first half of fiscal 2011 reflect our financial position as of July 2, 2011. The second quarter and first half of fiscal 2010 ended on July 3, 2010.

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

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

NOTE 3 – ACQUISITION OF BONNIE TOGS:

As noted above, on June 30, 2011, Northstar purchased all of the outstanding shares of capital stock of Bonnie Togs (the "Acquisition") for total consideration of up to CAD $95 million. CAD $60 million was paid in cash at closing. Such payment is subject to post-closing adjustments. The sellers may also be paid contingent consideration ranging from zero to CAD $35 million if the Canadian business meets certain earnings targets beginning July 1, 2011 and ending on June 27, 2015. Sellers may receive a portion of the contingent consideration of up to CAD $25 million if interim earnings targets are met through June 2013 and June 2014, respectively. Any such payments are not recoverable by the Company in the event of any failure to meet overall targets. As of July 2, 2011, the Company has included a discounted contingent consideration liability of approximately $24 million in its consolidated balance sheet based upon the high probability that Bonnie Togs will attain its earnings targets. The Company will continue to reevaluate the fair value of the contingent consideration based upon the probability of Bonnie Togs attaining its earnings targets at each reporting period.

The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed at June 30, 2011, the date of the Acquisition, subject to change upon finalization of purchase accounting:

(USD in thousands)		
Current assets	$	40,376
Property, plant, and equipment, net		8,246
Goodwill		54,480
Bonnie Togs tradename		623
Non-compete agreements		311
Total asset acquired		104,036
Current liabilities		16,698
Non-current liabilities		1,895
Total liabilities assumed		18,593
Net assets acquired	$	85,443

In connection with the Acquisition, the Company recorded total acquired intangible assets of approximately $55.4 million, including $54.5 million of goodwill, $0.6 million related to the Bonnie Togs tradename (estimated life of two years), and $0.3 million related to non-compete agreements for certain executives (estimated life of four years). The fair value of these intangible assets are subject to change until finalization of purchase accounting.

NOTE 4 – COMPREHENSIVE INCOME:

Comprehensive income is summarized as follows:

(dollars in thousands)	For the three-month periods ended July 2, 2011	For the three-month periods ended July 3, 2010	For the six-month periods ended July 2, 2011	For the six-month periods ended July 3, 2010
Net income	$ 12,659	$ 19,096	$ 44,782	$ 61,921
Foreign currency translation adjustments	(99)	--	(99)	--
Unrealized gain on interest rate swap agreements, net of tax of $174 and $272, respectively	--	297	--	463
Total comprehensive income	$ 12,560	$ 19,393	$ 44,683	$ 62,384

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

NOTE 5 – LONG-TERM DEBT:

Long-term debt consisted of the following:

(dollars in thousands)	July 2, 2011	January 1, 2011	July, 3, 2010
Revolving credit facility	$ 236,000	$ 236,000	$ --
Former term loan	--	--	232,772
Current maturities	--	--	(3,503)
Total long-term debt	$ 236,000	$ 236,000	$ 229,269

On October 15, 2010, the Company entered into a $375 million ($130 million sub-limit for letters of credit and a swing line sub-limit of $40 million) revolving credit facility with Bank of America as sole lead arranger and administrative agent, JP Morgan Chase Bank as syndication agent, and other financial institutions. The revolving credit facility was immediately drawn upon to pay off the Company's former term loan of $232.2 million and pay transaction fees and expenses of $3.8 million, leaving approximately $130 million available under the revolver for future borrowings (net of letters of credit of approximately $8.6 million). At January 1, 2011, we had approximately $236.0 million in revolver borrowings, exclusive of $8.6 million of outstanding letters of credit, at an effective interest rate of 2.51%. At July 2, 2011, we had approximately $236.0 million in revolver borrowings, exclusive of $18.5 million of outstanding letters of credit, at an effective interest rate of 2.44%.

The term of the 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 ½ of 1%, (y) the rate of interest in effect for such day as publicly announced from time to time by Bank of America, N.A. as its prime rate, or (z) the Eurodollar Rate plus 1%, plus, in each case, an applicable margin initially equal to 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 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. As of July 2, 2011, the Company believes it was in compliance with its debt covenants.

The Company's former senior credit facility was comprised of a $232.8 million term loan (the "former term loan") and a $125 million revolving credit facility (the "former revolver") (including a sub-limit for letters of credit of $80 million). There were no borrowings outstanding under the former revolver, exclusive of approximately $8.6 million of outstanding letters of credit at July 3, 2010. Amounts borrowed under the former term loan had an applicable rate of LIBOR + 1.50%, regardless of the Company's overall leverage level. Interest was payable at the end of interest rate reset periods, which vary in length but in no case exceeded 12 months for LIBOR rate loans and quarterly for prime rate loans. The effective interest rate on former term loan borrowings as of July 3, 2010 was 1.8%.

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

NOTE 6 – GOODWILL AND OTHER INTANGIBLE ASSETS:

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

Goodwill as of July 2, 2011, represents the excess of the cost of the acquisition of Carter's, Inc., which was consummated on August 15, 2001, and the acquisition of Bonnie Togs, which was consummated on June 30, 2011, over the fair value of the net assets acquired. Our goodwill is not deductible for tax purposes. Our Carter's and Bonnie Togs goodwill and Carter's and OshKosh tradenames are deemed to have indefinite lives and are not being amortized. The Bonnie Togs tradename and non-compete agreements are expected to have definite lives and are being amortized over two and four years, respectively.

The Company's intangible assets were as follows:

			July 2, 2011			January 1, 2011	
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount
Carter's goodwill (1)	Indefinite	$136,570	$ --	$136,570	$136,570	$ --	$136,570
Bonnie Togs goodwill	Indefinite	$54,480	$ --	$54,480	$--	$ --	$--
Carter's tradename	Indefinite	$220,233	$ --	$220,233	$220,233	$ --	$220,233
OshKosh tradename	Indefinite	$85,500	$ --	$85,500	$85,500	$ --	$85,500
Bonnie Togs tradename	2 years	$623	$ --	$623	$--	$ --	$--
Non-compete agreements	4 years	$311	$ --	$311	$--	$ --	$--
OshKosh licensing agreements	4.7 years	$19,100	$ 19,100	$--	$19,100	$ 19,100	$--

			July 3, 2010	
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount
Carter's goodwill (1)	Indefinite	$ 136,570	$ --	$ 136,570
Bonnie Togs goodwill	Indefinite	$ --	$ --	$ --
Carter's tradename	Indefinite	$ 220,233	$ --	$ 220,233

OshKosh tradename	Indefinite	$ 85,500	$ --	$ 85,500
Bonnie Togs tradename	2 years	$ --	$ --	$ --
Non-compete agreements	4 years	$ --	$ --	$ --
OshKosh licensing agreements	4.7 years	$ 19,100	$ 18,963	$ 137

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

Amortization expense for intangible assets was approximately $0.8 million and $1.6 million for the three and six-month periods ended July 3, 2010, respectively.

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

NOTE 7 – INCOME TAXES:

The Company and its subsidiaries file income tax returns in the United States and in various states and local jurisdictions. The Internal Revenue Service initiated an income tax audit for fiscal 2009 during the second quarter of fiscal 2011. In most cases, the Company is no longer subject to state and local tax authority examinations for years prior to fiscal 2007.

As of July 2, 2011, the Company had gross unrecognized tax benefits of approximately $9.5 million, $6.6 million of which, if ultimately recognized, will impact the Company's effective tax rate in the period settled. The Company has recorded tax positions for which the ultimate deductibility is highly certain, but for which there is uncertainty about the timing of such deductions. Because of deferred tax accounting, changes in the timing of these deductions would not impact the annual effective tax rate, but would accelerate the payment of cash to the taxing authorities.

Included in the reserves for unrecognized tax benefits as of July 2, 2011, are approximately $2.0 million of reserves for which the statute of limitations is expected to expire in the third or fourth quarter of fiscal 2011. If these tax benefits are ultimately recognized, such recognition, net of federal income taxes, 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. During the second quarter of fiscal 2011 and 2010, the Company recognized interest expense on uncertain tax positions of approximately $0.1 million. The Company had approximately $0.8 million, $0.6 million, and $0.7 million of interest accrued as of July 2, 2011, January 1, 2011, and July 3, 2010, respectively.

NOTE 8 – FAIR VALUE MEASUREMENTS:

The Company accounts for its fair value measurements in accordance with accounting guidance which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The fair value hierarchy for disclosure of fair value measurements is as follows:

Level 1	- Quoted prices in active markets for identical assets or liabilities
Level 2	- Quoted prices for similar assets and liabilities in active markets or inputs that are observable
Level 3	- Inputs that are unobservable (for example, cash flow modeling inputs based on assumptions)

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

July 2, 2011	January 1, 2011	July 3, 2010

(dollars in millions)	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets									
Investments	$ 55.3	$ --	$ --	$ 226.5	$ --	$ --	$ 215.3	$ 15.0	$ --
Liabilities									
Interest rate swap agreements	$ --	$ --	$ --	$ --	$ --	$ --	$ --	$ 0.6	$ --

At July 2, 2011, we had approximately $30.3 million of cash invested in a JP Morgan money market deposit account and $25.0 million in U.S. Treasury bills.

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

NOTE 8 – FAIR VALUE MEASUREMENTS: (Continued)

At January 1, 2011, we had approximately $151.5 million of cash invested in money market deposit accounts ($73.3 million in Bank of America and $78.2 million in JP Morgan) and $75.0 million in U.S. Treasury bills.

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

Our former senior credit facility required us to hedge at least 25% of our variable rate debt under this facility. The Company historically entered into interest rate swap agreements in order to hedge the risk of interest rate fluctuations. These interest rate swap agreements were designated as cash flow hedges of the variable interest payments on a portion of our variable rate former term loan debt. Our interest rate swap agreements were traded in the over-the-counter market. Fair values were 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 were classified as current as their terms spanned less than one year.

As of July 3, 2010, approximately $130.7 million of our $232.8 million of outstanding debt was hedged under interest rate swap agreements. In connection with the repayment of the Company's former term loan, the Company terminated its two remaining interest rate swap agreements totaling $100.0 million originally scheduled to mature in January 2011.

On June 22, 2011, as part of the Acquisition, the Company entered into a forward foreign currency exchange contract to reduce its risk from exchange rate fluctuations on the purchase price of Bonnie Togs. The contract was settled on June 30, 2011 and a gain of $0.2 million was recognized in earnings.

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

	Asset Derivatives		Liability Derivatives	
(dollars in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
July 2, 2011	Prepaid expenses and other current assets	$ --	Other current liabilities	$ --
January 1, 2011	Prepaid expenses and other current assets	$ --	Other current liabilities	$ --
July 3, 2010	Prepaid expenses and other current assets	$ --	Other current liabilities	$ 0.6

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

NOTE 8 – FAIR VALUE MEASUREMENTS: (Continued)

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

	For the three-month period ended July 2, 2011		For the six-month period ended July 2, 2011	
(dollars in thousands)	Amount of gain recognized in accumulated other comprehensive income (loss) on effective hedges	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	Amount of loss reclassified from accumulated other comprehensive income (loss) into interest expense
Interest rate hedge agreements	$ --	$ --	$ --	$ --

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

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

	Gains (losses) recognized in earnings	
(dollars in thousands)	For the three and six-month periods ended July 2, 2011	For the three and six-month periods ended July 3, 2010
Foreign exchange forward contract	$ 231	$ --

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NOTE 9 – EMPLOYEE BENEFIT PLANS:

Under a defined benefit plan frozen in 1991, we offer a comprehensive post-retirement medical plan to current and certain future retirees and their spouses until they become eligible for Medicare or a Medicare Supplement Plan. We also offer life insurance to current and certain future retirees. Employee contributions are required as a condition of participation for both medical benefits and life insurance and our liabilities are net of these expected employee contributions. See Note 7 "Employee Benefit Plans" to our audited consolidated financial statements in our most recently filed Annual Report on Form 10-K for further information.

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

	For the three-month periods ended		For the six-month periods ended	
(dollars in thousands)	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Service cost – benefits attributed to service during the period	$ 18	$ 23	$ 36	$ 46
Interest cost on accumulated post-retirement benefit obligation	106	133	212	266
Amortization net actuarial gain	(5)	(7)	(10)	(14)
Total net periodic post-retirement benefit cost	$ 119	$ 149	$ 238	$ 298

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

	For the three-month periods ended		For the six-month periods ended	
(dollars in thousands)	July 2, 2011	July 3, 2010	July 2, 2011	July 3, 2010
Interest cost on accumulated pension benefit obligation	$ 8	$ 12	$ 16	$ 24

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 six-month periods ended	
(dollars in thousands)	July 2,	July 3,	July 2,	July 3,

	2011	2010	2011	2010
Interest cost on accumulated pension benefit obligation	$ 613	$ 598	$ 1,227	$ 1,196
Expected return on assets	(778)	(719)	(1,556)	(1,438)
Amortization of actuarial loss	--	33	--	67
Total net periodic pension (benefit) expense	$ (165)	$ (88)	$ (329)	$ (175)

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

During the second quarter and first half of fiscal 2011, the Company issued 38,520 shares of common stock at a fair market value of $30.38 per share to its non-management board members. In connection with this issuance, we recognized approximately $1.2 million in stock-based compensation expense. During the second quarter and first half of fiscal 2010, the Company issued 24,032 shares of common stock at a fair market value of $33.29 per share to its non-management board members. In connection with this issuance, we recognized approximately $800,000 in stock-based compensation expense. 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 was authorized to purchase up to $100 million of its outstanding common shares (the "2007 Authorization"). On June 15, 2010, the Company's Board of Directors approved a new share repurchase authorization, pursuant to which the Company is authorized to purchase up to an additional $100 million of its outstanding common shares (the "2010 Authorization"). The Company has completed repurchase of outstanding shares in the amount totaling the entire $100 million approved under the 2007 Authorization. Under the 2010 Authorization, the Company has repurchased and retired 1,686,830 shares, or approximately $41.1 million, of its common stock at an average price of $24.37 per share. The total remaining capacity under this authorization was approximately $58.9 million as of July 2, 2011. This authorization has no expiration date.

The Company did not repurchase any shares of its common stock during the three and six-month periods ended July 2, 2011 and July 3, 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. Future repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, other investment priorities, and other factors.

NOTE 11 – STOCK-BASED COMPENSATION:

Under our Amended and Restated 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, and performance-based stock awards, intended to help defray the cost of awards. The fair value of time-based or performance-based stock option grants are estimated on the date of grant using the Black-Scholes option pricing method with the following weighted-average assumptions used for grants issued during the six-month period ended July 2, 2011.

Assumptions

Volatility	34.96	%
Risk-free interest rate	2.86	%
Expected term (years)	7	
Dividend yield	--	

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

CARTER'S, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE 11 – STOCK-BASED COMPENSATION: (Continued)

The following table summarizes our stock option and restricted stock activity during the six-month period ended July 2, 2011:

	Time-based stock options	Restricted stock
Outstanding, January 1, 2011	2,471,486	481,413
Granted	404,100	382,820
Exercised	(293,508)	--
Vested restricted stock	--	(196,282)
Forfeited	(58,850)	(26,550)
Expired	(7,800)	--
Outstanding, July 2, 2011	2,515,428	641,401
Exercisable, July 2, 2011	1,502,566	--

During the three-month period ended July 2, 2011, we granted 37,500 time-based stock options with a weighted-average Black-Scholes fair value of $12.50 per share and a weighted-average exercise price of $30.18 per share. In connection with this grant, we recognized approximately $16,000 in stock-based compensation expense during the three-month period ended July 2, 2011.

During the six-month period ended July 2, 2011, we granted 404,100 time-based stock options with a weighted-average Black-Scholes fair value of $12.05 per share and a weighted-average exercise price of $28.60 per share. In connection with these grants, we recognized approximately $375,000 in stock-based compensation expense during the six-month period ended July 2, 2011.

During the three-month period ended July 2, 2011, we granted 58,620 shares of restricted stock to employees with a weighted-average fair value on the date of grant of $30.31 per share. In connection with these grants, we recognized approximately $21,000 in stock-based compensation expense during the three-month period ended July 2, 2011.

During the six-month period ended July 2, 2011, we granted 382,820 shares of restricted stock to employees with a weighted-average fair value on the date of grant of $28.72 per share. In connection with these grants, we recognized approximately $743,000 in stock-based compensation expense during the six-month period ended July 2, 2011.

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
2011 (period from July 3 through December 31, 2011)	$1,775	$2,560	$4,335
2012	3,098	4,704	7,802
2013	2,319	3,645	5,964
2014	1,298	2,556	3,854
Total	$8,490	$13,465	$21,955

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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NOTE 12 – SEGMENT INFORMATION:

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

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

	For the three-month periods ended				For the six-month periods ended			
(dollars in thousands)	July 2, 2011	% of Total	July 3, 2010	% of Total	July 2, 2011	% of Total	July 3, 2010	% of Total
Net sales:								
Carter's:								
Wholesale	$128,133	32.5 %	$111,248	34.0 %	$316,011	36.6 %	$257,506	35.0 %
Retail (a)	142,921	36.2 %	113,593	34.7 %	280,783	32.5 %	231,732	31.5 %
Mass Channel	50,625	12.8 %	38,838	11.9 %	117,261	13.6 %	106,758	14.5 %
Carter's net sales	321,679	81.5 %	263,679	80.6 %	714,055	82.7 %	595,996	81.0 %
OshKosh:								
Retail (a)	57,112	14.5 %	51,959	15.9 %	111,106	12.9 %	107,104	14.5 %
Wholesale	15,697	4.0 %	11,371	3.5 %	38,327	4.4 %	32,958	4.5 %
OshKosh net sales	72,809	18.5 %	63,330	19.4 %	149,433	17.3 %	140,062	19.0 %
Total net sales	$394,488	100.0 %	$327,009	100.0 %	$863,488	100.0 %	$736,058	100.0 %
Operating income (loss):		% of segment net sales		% of segment net sales		% of segment net sales		% of segment net sales