

CARTERS INC
Form 10-Q
April 30, 2019

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
X 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 30, 2019 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 (I.R.S. Employer Identification No.)
incorporation or organization)

Phipps Tower

3438 Peachtree Road NE, Suite 1800

Atlanta, Georgia 30326

(Address of principal executive offices, including zip code)

(678) 791-1000

(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 every Interactive Data File required to be submitted 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 such files). Yes (X) No ()

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer (X) Accelerated Filer ()

Non-Accelerated Filer () Smaller Reporting Company ()

Emerging Growth Company ()

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ()

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes (X) No (X)

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

Common Stock

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	Outstanding Shares at April 24, 2019
Common stock, par value \$0.01 per share	45,209,033

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 per share data)
(unaudited)

	March 30, 2019	December 29, 2018	March 31, 2018
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 160,149	\$ 170,077	\$ 180,256
Accounts receivable, net	239,239	258,259	221,186
Finished goods inventories	519,752	574,226	479,344
Prepaid expenses and other current assets	51,887	40,396	54,297
Total current assets	971,027	1,042,958	935,083
Property, plant, and equipment, net of accumulated depreciation of \$468,251, \$448,898, and \$416,153, respectively	337,475	350,437	369,064
Operating lease assets	704,554	—	—
Tradenames, net	365,630	365,692	365,506
Goodwill	228,019	227,101	230,008
Customer relationships, net	43,669	44,511	47,369
Other assets	29,570	28,159	28,176
Total assets	\$2,679,944	\$ 2,058,858	\$ 1,975,206
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$ 108,221	\$ 199,076	\$ 116,310
Current operating lease liabilities	152,157	—	—
Other current liabilities	101,376	128,345	109,626
Total current liabilities	361,754	327,421	225,936
Long-term debt, net	625,278	593,264	617,541
Deferred income taxes	90,230	87,347	87,422
Long-term operating lease liabilities	692,056	—	—
Other long-term liabilities	61,222	181,393	189,493
Total liabilities	\$ 1,830,540	\$ 1,189,425	\$ 1,120,392
Commitments and contingencies - Note 14			
Stockholders' equity:			
Preferred stock; par value \$.01 per share; 100,000 shares authorized; none issued or outstanding at March 30, 2019, December 29, 2018, and March 31, 2018	\$—	\$—	\$—
Common stock, voting; par value \$.01 per share; 150,000,000 shares authorized; 45,379,827, 45,629,014 and 47,113,576 shares issued and outstanding at March 30, 2019, December 29, 2018 and March 31, 2018, respectively	454	456	471
Accumulated other comprehensive loss	(39,428)	(40,839)	(30,855)
Retained earnings	888,378	909,816	885,198
Total stockholders' equity	849,404	869,433	854,814

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Total liabilities and stockholders' equity	\$2,679,944	\$2,058,858	\$1,975,206
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See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Fiscal quarter ended	
	March 30, 2019	March 31, 2018
Net sales	\$741,057	\$755,786
Cost of goods sold	425,190	423,309
Gross profit	315,867	332,477
Royalty income, net	8,544	7,994
Selling, general, and administrative expenses	263,652	280,162
Operating income	60,759	60,309
Interest expense	9,629	7,985
Interest income	(228)	(166)
Other expense (income), net	(211)	(382)
Loss on extinguishment of debt	7,823	—
Income before income taxes	43,746	52,872
Provision for income taxes	9,280	10,403
Net income	\$34,466	\$42,469
Basic net income per common share	\$0.76	\$0.90
Diluted net income per common share	\$0.75	\$0.89
Dividend declared and paid per common share	\$0.50	\$0.45

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Fiscal quarter ended	
	March 30, 2019	March 31, 2018
Net income	\$34,466	\$42,469
Other comprehensive income:		
Foreign currency translation adjustments	2,911	(1,762)
Comprehensive income	\$37,377	\$40,707

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(amounts in thousands, except share amounts)

(unaudited)

	Common stock - shares	Common stock - \$	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total stockholders' equity
Balance at December 30, 2017	47,178,346	\$ 472	\$ —	\$ (29,093)	\$ 886,037	\$ 857,416
Exercise of stock options	95,006	1	4,768	—	—	4,769
Withholdings from vesting of restricted stock	(55,164)	(1)	(6,582)	—	—	(6,583)
Restricted stock activity	116,701	1	(1)	—	—	—
Stock-based compensation expense	—	—	4,944	—	—	4,944
Repurchase of common stock	(221,313)	(2)	(3,129)	—	(22,064)	(25,195)
Cash dividends declared and paid	—	—	—	—	(21,244)	(21,244)
Comprehensive income	—	—	—	(1,762)	42,469	40,707
Balance at March 31, 2018	47,113,576	\$ 471	\$ —	\$ (30,855)	\$ 885,198	\$ 854,814
Balance at December 29, 2018	45,629,014	\$ 456	\$ —	\$ (40,839)	\$ 909,816	\$ 869,433
Exercise of stock options	72,192	1	4,779	—	—	4,780
Withholdings from vesting of restricted stock	(43,844)	—	(4,077)	—	—	(4,077)
Restricted stock activity	182,722	2	(2)	—	—	—
Stock-based compensation expense	—	—	4,613	—	—	4,613
Repurchase of common stock	(460,257)	(5)	(5,313)	—	(34,648)	(39,966)
Cash dividends declared and paid	—	—	—	—	(22,756)	(22,756)
Comprehensive income	—	—	—	2,911	34,466	37,377
Reclassification of tax effects ^(*)	—	—	—	(1,500)	1,500	—
Balance at March 30, 2019	45,379,827	\$ 454	\$ —	\$ (39,428)	\$ 888,378	\$ 849,404

The Company reclassified \$1.5 million of tax benefits from "Accumulated other comprehensive loss" to "Retained earnings" for the tax effects resulting from the December 22, 2017 enactment of the Tax Cut and Jobs Act in accordance with the adoption of ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income in the first quarter of fiscal 2019.

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Fiscal quarter ended	
	March 30, 2019	March 31, 2018
Cash flows from operating activities:		
Net income	\$34,466	\$42,469
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of property, plant, and equipment	22,629	21,137
Amortization of intangible assets	937	921
Amortization of debt issuance costs	367	431
Stock-based compensation expense	4,613	4,944
Unrealized foreign currency exchange gain, net	(210)	(353)
Provisions for doubtful accounts receivable from customers	(2,562)	11,051
Loss on extinguishment of debt	7,823	—
Loss on disposal of property, plant, and equipment, net of recoveries	433	350
Deferred income taxes	3,242	2,968
Effect of changes in operating assets and liabilities:		
Accounts receivable	21,891	8,623
Finished goods inventories	55,852	68,294
Prepaid expenses and other assets	(717,808)	(1,970)
Accounts payable and other liabilities	605,350	(94,758)
Net cash provided by operating activities	\$37,023	\$64,107
Cash flows from investing activities:		
Capital expenditures	\$(9,371)	\$(14,744)
Disposals and recoveries from property, plant, and equipment	—	373
Net cash used in investing activities	\$(9,371)	\$(14,371)
Cash flows from financing activities:		
Proceeds from senior subordinated notes due 2027	\$500,000	\$—
Payment of senior subordinated notes due 2021	(400,000)	—
Premiums paid to extinguish debt	(5,252)	—
Payment of debt issuance costs	(5,722)	—
Borrowings under secured revolving credit facility	70,000	50,000
Payments on secured revolving credit facility	(135,000)	(50,000)
Repurchases of common stock	(39,966)	(25,195)
Dividends paid	(22,756)	(21,244)
Withholdings from vestings of restricted stock	(4,077)	(6,583)
Proceeds from exercises of stock options	4,780	4,769
Net cash used in financing activities	(37,993)	(48,253)
Effect of exchange rate changes on cash and cash equivalents	413	279
Net (decrease) / increase in cash and cash equivalents	(9,928)	1,762
Cash and cash equivalents, beginning of period	170,077	178,494
Cash and cash equivalents, end of period	\$160,149	\$180,256

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," "its," "us" and "our") design, source, and market branded childrenswear under the Carter's, Child of Mine, Just One You, Precious Firsts, Precious Baby, Simple Joys, OshKosh B'gosh ("OshKosh"), Skip Hop and other brands. The Company's products are sourced through contractual arrangements with manufacturers worldwide for: 1) wholesale distribution to leading department stores, national chains, and specialty retailers domestically and internationally and 2) distribution to the Company's own retail stores and eCommerce sites that market its brand name merchandise and other licensed products manufactured by other companies. As of March 30, 2019, the Company operated 1,063 retail stores in the United States, Canada, and Mexico.

NOTE 2 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). All intercompany transactions and balances have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all normal and recurring adjustments necessary to state fairly the consolidated financial condition, results of operations, comprehensive income, statement of stockholders' equity, and cash flows of the Company for the interim periods presented. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the fiscal quarter ended March 30, 2019 are not necessarily indicative of the results that may be expected for the current fiscal year ending December 28, 2019.

The preparation of these unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

The accompanying condensed consolidated balance sheet as of December 29, 2018 was derived from the Company's audited consolidated financial statements included in its most recently filed Annual Report on Form 10-K. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC and the instructions to Form 10-Q.

Accounting Policies

The accounting policies the Company follows are set forth in its most recently filed Annual Report on Form 10-K. There have been no material changes to these accounting policies, except as noted below for new accounting pronouncements adopted at the beginning of fiscal 2019.

Leases

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASC No. 842, Leases, a new standard related to leases to increase transparency and comparability among organizations by requiring the recognition of right-of-use ("ROU") assets and lease liabilities on the balance sheet. Most prominent among the changes in the standard is the recognition of ROU assets and lease liabilities by lessees for those leases classified as operating. Under the standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

At the beginning of fiscal 2019, the Company adopted the provisions of ASC No. 842, Leases, using a modified retrospective approach as an optional transition method. This approach allows the Company to apply the standard and related disclosures to the financial statements for the period of adoption and to apply the old guidance in the comparative periods.

The standard had a material impact on our consolidated balance sheets, but did not have a material impact on our consolidated income statements or statement of cash flows. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases. Finance leases are not material to the Company's consolidated balance

sheets, consolidated income statements or statement of cash flows.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Financial Presentation

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease assets, current operating lease liabilities, and long-term operating lease liabilities in our consolidated balance sheets. ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option.

The operating lease ROU asset also includes initial direct costs and excludes lease incentives. Lease expense is recognized on a straight-line basis over the lease term.

Certain of our lease agreements include variable rental payments based on a percentage of retail sales over contractual levels and others include variable rental payments adjusted periodically for inflation. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Policy Elections

Practical Expedient Package: The Company has elected the following expedients and apply them consistently to all leases:

The Company will not revisit whether a contract is, or contains, a lease under the ASC 842 definition of a lease.

Lease classification determined under prior guidance will not be reevaluated under ASC 842.

Previously capitalized initial direct costs under prior guidance will be carried forward. Any initial direct costs after the effective date will be included within the ROU asset under ASC 842.

Portfolio approach - In general, the Company accounts for the underlying leased asset and applies a discount rate at the lease level. However, there are certain non-real estate leases for which the Company utilizes the portfolio method by aggregating similar leased assets based on the underlying lease term.

Non-lease component - The Company has lease agreements with lease and non-lease components. The Company elected a policy to account for lease and non-lease components as a single component for all asset classes.

Short-term lease - Leases with an initial term of 12 months or less are not recorded on the balance sheet.

Discount rate - As most of the Company's leases do not provide an implicit rate, the Company uses the incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments.

Renewal options - The Company evaluates the inclusion of renewal options on a lease by lease basis. In general, for leased retail real estate, the Company does not include renewal options in the underlying lease term.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02)

In first quarter of fiscal 2019, the Company adopted ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("ASU 2018-02"). The adoption of ASU 2018-02 allowed the Company to move "stranded" tax amounts from its accumulated other comprehensive loss to retained earnings. The effect of the adoption of ASU 2018-02 was not material to the Company's financial position and did not have an effect on the Company's consolidated results of operations or cash flows.

NOTE 3 - REVENUE RECOGNITION

The Company's revenues are earned from contracts or arrangements with retail and wholesale customers and licensees. Contracts include written agreements, as well as arrangements that are implied by customary practices or law.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Disaggregation of Revenue

The Company sells its products directly to consumers ("direct-to-consumer") and to other retail companies and partners that subsequently sell the products directly to their own retail customers. The Company also earns royalties from its licensees. Disaggregated revenues from these sources for the first quarter ended fiscal 2019 and 2018 were as follows:

(dollars in thousands)	Fiscal quarter ended March 30, 2019			
	U.S. Retail	U.S. Wholesale	International	Total
Wholesale channel	\$—	\$ 275,367	\$ 40,788	\$ 316,155
Direct-to-consumer	377,053	—	47,849	424,902
	\$377,053	\$ 275,367	\$ 88,637	\$ 741,057

Royalty income	\$ 1,991	\$ 5,850	\$ 703	\$ 8,544
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(dollars in thousands)	Fiscal quarter ended March 31, 2018			
	U.S. Retail	U.S. Wholesale	International	Total
Wholesale channel	\$—	\$ 280,832	\$ 37,713	\$ 318,545
Direct-to-consumer	383,742	—	53,499	437,241
	\$383,742	\$ 280,832	\$ 91,212	\$ 755,786

Royalty income	\$ 1,585	\$ 5,845	\$ 564	\$ 7,994
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Accounts Receivable from Customers and Licensees

The components of Accounts receivable, net, were as follows:

(dollars in thousands)	March 30, 2019	December 29, 2018	March 31, 2018
Trade receivables from wholesale customers, net	\$ 226,455	\$ 244,258	\$ 226,348
Royalties receivable	7,511	9,279	7,108
Tenant allowances and other receivables	15,614	16,588	10,972
Total gross receivables	\$ 249,580	\$ 270,125	\$ 244,428
Less:			
Wholesale accounts receivable reserves	(10,341)	(11,866)	(23,242)
Accounts receivable, net	\$ 239,239	\$ 258,259	\$ 221,186

Contract Assets and Liabilities

The Company's contract assets are not material.

Contract Liabilities

The Company recognizes a contract liability when it has received consideration from the customer and has a future obligation to transfer goods to the customer. Total contract liabilities consisted of the following amounts:

(dollars in thousands)	March 30, 2019	December 29, 2018	March 31, 2018
Contract liabilities-current:			
Unredeemed gift cards	\$ 13,724	\$ 14,471	\$ 10,903
Unredeemed customer loyalty rewards	8,520	7,764	8,176
Total contract liabilities-current ^(*)	\$ 22,244	\$ 22,235	\$ 19,079

*Included with Other current liabilities on the Company's consolidated balance sheet.

NOTE 4 - LEASES

We have operating leases for retail stores, distribution centers, corporate offices, data centers, and certain equipment. Our leases have remaining lease terms of 1 year to 20 years, some of which may include options to extend the leases

for up to 5 years, and some of which may include options to early terminate the lease.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of March 30, 2019, the Company's finance leases were not material to the consolidated balance sheets, consolidated statements of operations or statement of cash flows.

The following components of lease expense are included in Selling, general and administrative expenses on the Company's consolidated statements of operations:

	Fiscal quarter ended March 30, 2019
(dollars in thousands)	
Operating lease cost	\$ 43,219
Variable lease cost (*)	16,448
Net lease cost	\$ 59,667

(*) Includes short-term leases, which are immaterial.

As of March 30, 2019, the weighted-average remaining operating lease term was 6.3 years and the weighted-average discount rate for operating leases was 4.48%.

Cash paid for amounts included in the measurement of operating lease liabilities in the first quarter of fiscal 2019 was \$47.3 million.

As of March 30, 2019, the maturities of lease liabilities were as follows:

(dollars in thousands)	Operating leases
Remainder of 2019	\$ 140,659
2020	173,972
2021	156,466
2022	134,733
2023	114,224
After 2023	256,141
Total lease payments	\$ 976,195
Less: Interest	(131,982)
Present value of lease liabilities(*)	\$ 844,213

As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the (*) information available at commencement date to determine the present value of lease payments. We used the incremental borrowing rate on December 30, 2018, for operating leases that commenced prior to that date.

As of March 30, 2019, the minimum rental commitments for additional operating lease contracts that have not yet commenced, primarily for retail stores, is \$12.1 million. These operating leases will commence in fiscal year 2019 with lease terms of 5 years to 10 years.

As of December 29, 2018, the minimum annual rental commitments under current non-cancellable operating leases were as follows:

(dollars in thousands)	Operating leases
2019	\$ 163,963
2020	150,010
2021	134,203
2022	116,773
2023	102,487
Thereafter	235,731
Total	\$ 903,167

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss consisted of the following:

(dollars in thousands)	March 30, 2019	December 29, 2018	March 31, 2018
Cumulative foreign currency translation adjustments	\$(30,053)	\$ (32,964)	\$(23,047)
Pension and post-retirement obligations ^(*)	(9,375)	(7,875)	(7,808)
Total accumulated other comprehensive loss	\$(39,428)	\$ (40,839)	\$(30,855)

(*) Net of income taxes of \$2.9 million, \$4.4 million, and \$4.4 million, respectively.

During the first quarter of both fiscal 2019 and fiscal 2018, no amounts were reclassified from accumulated other comprehensive loss to the statement of operations.

NOTE 6 – GOODWILL AND INTANGIBLE ASSETS

The Company's goodwill and intangible assets were as follows:

(dollars in thousands)	Weighted-average useful life	March 30, 2019			December 29, 2018		
		Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount
Carter's goodwill	Indefinite	\$136,570	\$ —	\$136,570	\$136,570	\$ —	\$136,570
Canada goodwill	Indefinite	39,704	—	39,704	38,869	—	38,869
Skip Hop goodwill	Indefinite	45,976	—	45,976	45,960	—	45,960
Carter's Mexico goodwill	Indefinite	5,769	—	5,769	5,702	—	5,702
Total goodwill		\$228,019	\$ —	\$228,019	\$227,101	\$ —	\$227,101
Carter's tradename	Indefinite	\$220,233	\$ —	\$220,233	\$220,233	\$ —	\$220,233
OshKosh tradename	Indefinite	85,500	—	85,500	85,500	—	85,500
Skip Hop tradename	Indefinite	56,800	—	56,800	56,800	—	56,800
Finite-life tradenames	5-20 years	3,911	\$ 814	3,097	3,911	\$ 752	3,159
Total tradenames, net		\$366,444	\$ 814	\$365,630	\$366,444	\$ 752	\$365,692
Skip Hop customer relationships	15 years	\$47,300	\$ 6,274	\$41,026	\$47,300	\$ 5,480	\$41,820
Carter's Mexico customer relationships	10 years	3,179	536	2,643	3,146	455	2,691
Total customer relationships, net		\$50,479	\$ 6,810	\$43,669			