

CARTERS INC
Form 10-Q
November 02, 2012

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 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 29, 2012 OR

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

Commission file number:
001-31829

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

Delaware
(state or other jurisdiction of
incorporation or organization)

13-3912933
(I.R.S. Employer Identification No.)

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

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

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

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

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

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

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

Common Stock

Outstanding Shares at November 1, 2012

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Common stock, par value \$0.01 per share

59,033,166



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)

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands, except for share data)

(unaudited)

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

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Cash and cash equivalents, end of period	\$254,321	\$81,634
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See accompanying notes to the unaudited condensed consolidated financial statements.

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

NOTE 1 – THE COMPANY:

Carter's, Inc. and its wholly owned subsidiaries (collectively, the "Company," "we," "us," "its," and "our") design, source, and market branded childrenswear under the Carter's, Child of Mine, Just One You, Precious Firsts, OshKosh, and other brands. Our products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic and international retailers and for our 398 Carter's, 167 OshKosh, and 79 Canadian retail stores that market our brand name merchandise and other licensed products manufactured by other companies.

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

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

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

NOTE 2 – BASIS OF PREPARATION:

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

In our opinion, the Company's accompanying unaudited condensed consolidated financial statements contain all adjustments necessary for a fair statement of our financial position as of September 29, 2012, the results of our operations for the three and nine-month periods ended September 29, 2012 and October 1, 2011, comprehensive income for the three and nine-month periods ended September 29, 2012 and October 1, 2011, changes in stockholders' equity for the nine-month period ended September 29, 2012, and cash flows for the nine-month periods ended September 29, 2012 and October 1, 2011. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the three and nine-month periods ended September 29, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending December 29, 2012. Our accompanying condensed consolidated balance sheet as of December 31, 2011 is derived from our audited consolidated financial statements included in our most recently filed Annual Report on Form 10-K, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP").

Certain information and footnote disclosure normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and the instructions to Form 10-Q. The accounting policies we follow are set forth in our most recently filed Annual Report on Form 10-K, in the notes to our audited consolidated financial statements for the fiscal year ended December 31, 2011.

Our fiscal year ends on the Saturday, in December or January, nearest the last day of December. The accompanying unaudited condensed consolidated financial statements for the third quarter and first nine months of fiscal 2012

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

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

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

NOTE 3 – ACQUISITION OF BONNIE TOGS:

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

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

The following table summarizes the fair values of the assets acquired and liabilities assumed at June 30, 2011, the date of the Acquisition:

(U.S. dollars in thousands)

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

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

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

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

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

NOTE 4 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):

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

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

NOTE 5 – LONG-TERM DEBT:

Long-term debt consisted of the following:

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

Revolving Credit Facility

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

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

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

expires August 31, 2017.

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

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CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

NOTE 5 – LONG-TERM DEBT: (Continued)

Pricing Options

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

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

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

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

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

Covenants

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

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

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

NOTE 6 – GOODWILL AND OTHER INTANGIBLE ASSETS:

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

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

The Company's intangible assets were as follows:

(dollars in thousands)	Weighted-average useful life	September 29, 2012			December 31, 2011		
		Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount
Carter's goodwill (1)	Indefinite	\$ 136,570	\$—	\$ 136,570	\$ 136,570	\$—	\$ 136,570
Bonnie Togs goodwill (2)	Indefinite	\$ 53,900	\$—	\$ 53,900	\$ 52,109	\$—	\$ 52,109
Carter's tradename	Indefinite	\$ 220,233	\$—	\$ 220,233	\$ 220,233	\$—	\$ 220,233
OshKosh tradename	Indefinite	\$ 85,500	\$—	\$ 85,500	\$ 85,500	\$—	\$ 85,500
Bonnie Togs tradename	2 years	\$ 612	\$ 383	\$ 229	\$ 592	\$ 150	\$ 442
Non-compete agreements	4 years	\$ 305	\$ 95	\$ 210	\$ 295	\$ 37	\$ 258

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

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

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

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

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

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

NOTE 7 – INCOME TAXES:

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

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

As of September 29, 2012, the Company had gross unrecognized tax benefits of approximately \$10.1 million, \$6.9 million of which, if ultimately recognized, will impact the Company's effective tax rate in the period settled. The Company has recorded tax positions for which the ultimate deductibility is highly certain, but for which there is uncertainty about the timing of such deductions. Because of deferred tax accounting, changes in the timing of these deductions would not impact the annual effective tax rate, but would accelerate the payment of cash to the taxing authorities.

Included in the reserves for unrecognized tax benefits are approximately \$1.7 million of reserves for which the statute of limitations is expected to expire within the next fiscal year. If these tax benefits are ultimately recognized, such recognition, net of federal income taxes, may impact our annual effective tax rate for fiscal 2012 or 2013 and the effective tax rate in the quarter in which the benefits are recognized.

We recognize interest related to unrecognized tax benefits as a component of interest expense and penalties related to unrecognized tax benefits as a component of income tax expense. During the third quarter of fiscal 2012, interest expense recorded on uncertain tax positions was not material. During the third quarter of fiscal 2011, the Company recognized a reduction of interest expense on uncertain tax positions of approximately \$0.1 million. During the nine-month periods ended September 29, 2012 and October 1, 2011, the Company recognized interest expense on uncertain tax positions of approximately \$0.2 million and \$0.1 million, respectively. The Company had approximately \$0.7 million, \$0.5 million, and \$0.7 million of interest accrued on uncertain tax positions as of September 29, 2012, December 31, 2011, and October 1, 2011, respectively.

NOTE 8 – FAIR VALUE MEASUREMENTS:

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

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

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

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

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

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

NOTE 8 – FAIR VALUE MEASUREMENTS: (Continued)

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

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

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

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

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

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

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

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

contingent consideration.

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

NOTE 8 – FAIR VALUE MEASUREMENTS: (Continued)

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

(dollars in millions)	Asset Derivatives		Liability Derivatives	
	Balance sheet location	Fair value	Balance sheet location	Fair value
September 29, 2012	Prepaid expenses and other current assets	\$—	Other current liabilities	\$0.1
December 31, 2011	Prepaid expenses and other current assets	\$0.6	Other current liabilities	\$—
October 1, 2011	Prepaid expenses and other current assets	\$1.1	Other current liabilities	\$—

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

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

NOTE 9 – EMPLOYEE BENEFIT PLANS:

Under a defined benefit plan frozen in 1991, we offer a comprehensive post-retirement medical plan to current and certain future retirees and their spouses until they become eligible for Medicare or a Medicare Supplement Plan. We also offer life insurance to current and certain future retirees. Employee contributions are required as a condition of participation for both medical benefits and life insurance and our liabilities are net of these expected employee contributions. See Note 8 “Employee Benefit Plans” to our audited consolidated financial statements in our most recently filed Annual Report on Form 10-K for further information.

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

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

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

NOTE 9 – EMPLOYEE BENEFIT PLANS: (Continued)

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

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

Under a defined benefit pension plan frozen as of December 31, 2005, certain current and former employees of OshKosh are eligible to receive benefits. The net periodic pension (benefit) expense associated with this pension plan and included in the statement of operations was comprised of:

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

NOTE 10 – COMMON STOCK:

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

During fiscal 2007, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company was authorized to purchase up to \$100 million of its outstanding common shares. During fiscal 2010, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company is authorized to purchase up to an additional \$100 million of its outstanding common shares. As of August 13, 2010, the Company had repurchased outstanding shares in the amount totaling the entire \$100 million authorized by the Board of Directors on February 16, 2007.

The Company did not repurchase any shares of its common stock during the first nine months of fiscal 2012 and 2011 pursuant to any repurchase authorization. Since inception of the repurchase program and through the first nine months

of fiscal 2012, the Company repurchased and retired 6,658,410 shares, or approximately \$141.1 million, of its common stock at an average price of \$21.19 per share. We have reduced common stock by the par value of such shares repurchased and have deducted the remaining excess repurchase price over par value from additional paid-in capital. Future repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, other investment priorities, and other factors.

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

NOTE 11 – STOCK-BASED COMPENSATION:

Under the Company's Amended and Restated Equity Incentive Plan (the "Plan"), the compensation committee of our Board of Directors may award incentive stock options (ISOs and non-ISOs), stock appreciation rights (SARs), restricted stock, unrestricted stock, stock deliverable on a deferred basis (including restricted stock units), and performance-based stock awards. The fair value of time-based or performance-based stock option grants are estimated on the date of grant using the Black-Scholes option pricing method with the following weighted-average assumptions used for grants issued during the nine-month period ended September 29, 2012.

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

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

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

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

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

During the nine-month period ended September 29, 2012, we granted 351,000 stock options with a weighted-average Black-Scholes fair value of \$15.16 per share and a weighted-average exercise price of \$42.81 per share. In connection

with these grants, we recognized approximately \$732,000 in stock-based compensation expense during the nine-month period ended September 29, 2012.

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

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

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

NOTE 11 – STOCK-BASED COMPENSATION: (Continued)

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

Unrecognized stock-based compensation expense related to outstanding unvested stock options and unvested restricted stock awards is expected to be recorded as follows:

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

NOTE 12 – SEGMENT INFORMATION:

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

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

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

NOTE 12 – SEGMENT INFORMATION: (Continued)

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

(dollars in thousands)	For the three-month periods ended				For the nine-month periods ended			
	September 29, 2012	% of Total	October 1, 2011	% of Total	September 29, 2012	% of Total	October 1, 2011	% of Total
Net sales:								
Carter's Wholesale	\$275,577	41.2 %	\$288,775	45.1 %	\$719,585	42.5 %	\$703,028	46.7 %
Carter's Retail (a)	217,299	32.5 %	184,498	28.9 %	563,764	33.3 %	465,281	31.0 %
Total Carter's	492,876	73.7 %	473,273	74.0 %	1,283,349	75.8 %	1,168,309	77.7 %
OshKosh Retail (a)	78,070	11.7 %	80,472	12.6 %	194,359	11.5 %	191,578	12.7 %
OshKosh Wholesale	28,276	4.2 %	26,472	4.1 %	61,339	3.6 %	61,248	4.1 %
Total OshKosh	106,346	15.9 %	106,944	16.7 %	255,698	15.1 %	252,826	16.8 %
International (b)	69,435	10.4 %	59,400	9.3 %	153,434	9.1 %	81,970	5.5 %
Total net sales	\$668,657	100.0 %	\$639,617	100.0 %	\$1,692,481	100.0 %	\$1,503,105	100.0 %
Operating income (loss):								
		% of segment net sales		% of segment net sales		% of segment net sales		% of segment net sales
Carter's Wholesale	\$53,284	19.3 %	\$33,023	11.4 %	\$129,500	18.0 %	\$90,603	12.9 %
Carter's Retail (a)	43,050	19.8 %	26,090	14.1 %	93,535	16.6 %	72,146	15.5 %
Total Carter's	96,334	19.5 %	59,113	12.5 %	223,035	17.4 %	162,749	13.9 %
OshKosh Retail (a)	3,397	4.4 %	1,694	2.1 %	(13,419)	(6.9)%	(9,427)	(4.9)%
OshKosh Wholesale	1,927	6.8 %	513	1.9 %	1,507	2.5 %	81	0.1 %
Total OshKosh	5,324	5.0 %	2,207	2.1 %	(11,912)	(4.7)%	(9,346)	(3.7)%

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International (b) (c)	16,643	24.0	%	7,934	13.4	%	30,371	19.8	%	16,519	20.2	%
Total segment operating income	118,301	17.7	%	69,254	10.8	%	241,494	14.3	%	169,922	11.3	%
Corporate expenses (d)	(22,909)	(e)(3.4	)%	(12,489)	(f)(2.0	)%	(57,875)	(e)(3.4	)%	(37,501)	(f)(2.5)%
Total operating income	\$95,392	14.3	%	\$56,765	8.9	%	\$183,619	10.8	%	\$132,421	8.8	%

(a) Includes eCommerce results.

(b) Net sales include international retail, eCommerce, and wholesale sales. Operating income includes international licensing income.

Includes charges of \$1.1 million and \$2.9 million for the three and nine-month periods ended September 29, 2012, respectively, associated with the revaluation of the Company's contingent consideration. Includes charges of \$1.0 million for both the three and nine-month periods ended October 1, 2011, associated with the revaluation of the Company's contingent consideration and \$5.9 million for both periods related to the amortization of the fair value step-up for Bonnie Togs inventory acquired.

(d) 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.

(e) Includes \$0.8 million and \$2.6 million in facility closure-related costs related to the closure of a distribution facility located in Hogansville, Georgia for the three and nine-month periods ended September 29, 2012, respectively. For the third quarter of fiscal 2012, the total closure-related costs consisted of severance of \$0.3 million, accelerated depreciation (included in selling, general, and administrative expenses) of \$0.4 million, and other closure costs of \$0.1 million. For the first nine months of fiscal 2012, the total closure-related costs consisted of severance of \$1.7 million, accelerated depreciation (included in selling, general, and administrative expenses) of \$0.8 million, and other closure costs of \$0.1 million.

(f) Includes \$0.1 million and \$2.3 million of professional service fees associated with the Acquisition for the three and nine-month period ended October 1, 2011, respectively.

For the third quarter and first nine months of fiscal 2012 and 2011, no customers accounted for 10% or more of our consolidated net sales.

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

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 awards, 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.

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	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Weighted-average number of common and common equivalent shares outstanding:				
Basic number of common shares outstanding	58,267,398	57,729,572	58,175,125	57,366,529
Dilutive effect of unvested restricted stock	189,203	121,633	179,816	108,577
Dilutive effect of stock options	693,526	464,846	663,749	599,805
Diluted number of common and common equivalent shares outstanding	59,150,127	58,316,051	59,018,690	58,074,911
Basic net income per common share:				
Net income	\$59,378,000	\$34,449,000	\$112,458,000	\$79,231,000
Income allocated to participating securities	(775,127)	(384,738)	(1,470,338)	(890,416)
Net income available to common shareholders	\$58,602,873	\$34,064,262	\$110,987,662	\$78,340,584
Basic net income per common share	\$1.01	\$0.59	\$1.91	\$1.37
Diluted net income per common share:				
Net income	\$59,378,000	\$34,449,000	\$112,458,000	\$79,231,000
Income allocated to participating securities	(766,127)	(381,699)	(1,453,966)	(881,305)
Net income available to common shareholders	\$58,611,873	\$34,067,301	\$111,004,034	\$78,349,695
Diluted net income per common share	\$0.99	\$0.58	\$1.88	\$1.35

For the three and nine-month periods ended September 29, 2012, anti-dilutive and performance-based restricted shares of 573,550 and 598,250, respectively, were excluded from the computations of diluted earnings per share. For both the three and nine-month periods ended October 1, 2011, anti-dilutive shares of 963,925 were excluded from the computations of diluted earnings per share.

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

NOTE 14 – FACILITY CLOSURE:

Consistent with the Company's strategy to strengthen our distribution capabilities, we decided to close our Hogansville, Georgia facility in 2013 and open a new, larger multi-channel distribution facility in Braselton, Georgia. On March 14, 2012, the Company announced to affected employees its plan to close the Hogansville facility. Approximately 210 employees are affected by this closure.

In conjunction with the plan to close the Hogansville distribution facility, the Company recorded approximately \$0.8 million and \$2.6 million in closing-related costs during the third quarter and first nine months of fiscal 2012, respectively. The total amount of charges consisted of severance of \$0.3 million and \$1.7 million, accelerated depreciation (included in selling, general, and administrative expenses) of \$0.4 million and \$0.8 million, and other closure costs of \$0.1 million for both the third quarter and the first nine months of fiscal 2012, respectively.

As of September 29, 2012, there was approximately \$1.8 million of restructuring reserves included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet related to this closure. The Company expects to incur additional closure-related charges of approximately \$0.9 million for one-time termination benefits (\$0.3 million in fiscal 2012 and \$0.6 million in fiscal 2013) and \$0.9 million in accelerated depreciation (\$0.4 million in fiscal 2012 and \$0.5 million in fiscal 2013), and other closure costs of \$1.0 million in fiscal 2013. The salvage value of this facility is estimated to be \$2.0 million.

The following table summarizes restructuring reserves related to the closure of the Hogansville facility which are included in other current liabilities in the accompanying unaudited condensed consolidated balance sheet as of September 29, 2012:

(dollars in thousands)	Severance	Other closure costs	Total
Balance at December 31, 2011	\$—	\$—	\$—
Provision	1,052	—	1,052
Payments	—	—	—
Balance at March 31, 2012	1,052	—	1,052
Provision	302	70	372
Payments	—	—	—
Balance at June 30, 2012	1,354	70	1,424
Provision	347	55	402
Payments	—	(70	) (70
Balance at September 29, 2012	\$1,701	\$55	\$1,756

When the Company determined that it was probable that the Hogansville facility would be closed, an impairment test was performed under the "held and used" model. We determined that the assets were not impaired; however, the estimated useful lives of the assets were reassessed and depreciation was accelerated over the expected remaining shutdown period.

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

NOTE 15 – RECENT ACCOUNTING PRONOUNCEMENTS:

In May 2011, the Financial Accounting Standards Board ("FASB") issued updated accounting guidance related to fair value measurements and disclosures that result in common fair value measurements and disclosures between GAAP and International Financial Reporting Standards. This guidance includes amendments that clarify the intent about the application of existing fair value measurements and disclosures, while other amendments change a principle or requirement for fair value measurements or disclosures. This guidance is effective for interim and annual periods beginning after December 15, 2011. The Company has included the required disclosures within Note 8, Fair Value Measurements.

In June 2011, the FASB issued guidance to amend the presentation of comprehensive income to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both instances, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. In December 2011, the FASB issued guidance to indefinitely defer provisions requiring reclassification adjustments out of other comprehensive income to be presented on the face of the financial statements. The other portions of the original guidance remain unchanged. These standards are effective for interim and annual periods beginning after December 15, 2011, and are to be applied retrospectively. The Company has included such disclosures within this quarterly report.

In September 2011, the FASB issued new guidance on testing goodwill for impairment. This guidance gives companies the option to perform a qualitative assessment to first assess whether the fair value of a reporting unit is less than its carrying amount. If an entity determines it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. This guidance is effective for fiscal years beginning after December 15, 2011. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

In July 2012, the FASB issued new guidance on impairment testing of indefinite-lived intangible assets, other than goodwill. The new guidance gives companies the option to perform a qualitative assessment to first assess whether the fair value of an indefinite-lived intangible asset is less than its carrying value. If the company determines it is not more likely than not that the fair value of the indefinite-lived intangible assets is less than the carrying value, then determining the fair value of the indefinite-lived intangible asset would be unnecessary. This guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012 and early adoption is permitted. The Company does not believe the adoption of this guidance will have a material impact on its consolidated financial statements.

NOTE 16 – SUBSEQUENT EVENT:

On October 11, 2012, the Company announced plans to consolidate its retail and financial operations currently managed in its Shelton, Connecticut facility with the Company's Atlanta, Georgia-based operations. The Company expects to complete this consolidation by the end of fiscal 2013. The Company anticipates pre-tax consolidation-related expenses in the range of \$35 million to \$40 million over the next 12 to 18 months. The Company expects approximately \$34 million of those charges to be cash, consisting of approximately \$13 million of

recruiting and relocation expenses, \$10 million of employee severance and other benefit costs, \$6 million of lease-related charges, and \$5 million of other associated costs. The Company also expects approximately \$3 million of those charges to be non-cash accelerated depreciation expense in connection with the office consolidation.

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

On June 30, 2011, we acquired Bonnie Togs, a Canadian children's apparel retailer and one of our principal licensees (the "Acquisition") for total consideration of up to CAD \$95 million, of which USD \$61.2 million was paid in cash at closing. The sellers may also be paid contingent consideration ranging from zero to CAD \$35 million if the Canadian business meets certain earnings targets for the period beginning July 1, 2011 and ending on June 27, 2015. Sellers may receive a portion of the contingent consideration of up to CAD \$25 million if interim earnings targets are met through June 2013 and June 2014, respectively. Any such payments are not recoverable by the Company in the event of any failure to meet overall targets.

As of September 29, 2012, the Company had a discounted contingent consideration liability of approximately \$29.4 million based upon the high probability that Bonnie Togs will attain its earnings targets, of which approximately \$14.4 million is included in other current liabilities and the remainder is included in other long-term liabilities, on the accompanying unaudited condensed consolidated balance sheet. The fair value of the discounted contingent consideration liability was approximately \$27.3 million as of June 30, 2012 and \$25.6 million as of December 31, 2011. The \$2.1 million increase in fair value during the third quarter of fiscal 2012 reflects accretion expense of approximately \$1.1 million and \$1.0 million reflecting an unfavorable foreign currency translation adjustment included in accumulated other comprehensive income. The \$3.8 million increase in the fair value of the liability during the first nine months of fiscal 2012 reflects accretion expense of \$2.9 million and a \$0.9 million unfavorable foreign currency translation adjustment reflected in accumulated other comprehensive income. The Company determined the fair value of the contingent consideration based upon a probability-weighted discounted cash flow analysis.

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

In conjunction with the plan to close the Hogansville, Georgia distribution facility, the Company recorded approximately \$0.8 million and \$2.6 million in closing-related costs during the third quarter and first nine months of fiscal 2012, respectively. For the third quarter of fiscal 2012, the total closure-related costs consisted of severance of \$0.3 million, accelerated depreciation (included in selling, general and administrative expenses) of \$0.4 million, and other closure costs of \$0.1 million. For the first nine months of fiscal 2012, the total closure-related costs consisted of severance of \$1.7 million, accelerated depreciation (included in selling, general and administrative expenses) of \$0.8 million, and other closure costs of \$0.1 million.

As of September 29, 2012, there was approximately \$1.8 million of restructuring reserves included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet related to this closure. The salvage value of this facility is estimated to be \$2.0 million.

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

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:

	For the three-month periods ended		For the nine-month periods ended		
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011	
Net sales					
Carter's Wholesale	41.2	% 45.1	% 42.5	% 46.7	%
Carter's Retail	32.5	% 28.9	% 33.3	% 31.0	%
Total Carter's	73.7	% 74.0	% 75.8	% 77.7	%
OshKosh Retail	11.7	% 12.6	% 11.5	% 12.7	%
OshKosh Wholesale	4.2	% 4.1	% 3.6	% 4.1	%
Total OshKosh	15.9	% 16.7	% 15.1	% 16.8	%
International	10.4	% 9.3	% 9.1	% 5.5	%
Consolidated net sales	100.0	% 100.0	% 100.0	% 100.0	%
Cost of goods sold	59.6	% 70.0	% 61.7	% 67.7	%
Gross profit	40.4	% 30.0	% 38.3	% 32.3	%
Selling, general, and administrative expenses	27.7	% 22.8	% 29.0	% 25.3	%
Royalty income	(1.6)	)% (1.7	)% (1.6	)% (1.9)%
Operating income	14.3	% 8.9	% 10.8	% 8.8	%
Interest expense, net	0.3	% 0.3	% 0.3	% 0.4	%
Foreign currency gain	—	% —	% —	% —	%
Income before income taxes	14.0	% 8.6	% 10.5	% 8.5	%
Provision for income taxes	5.2	% 3.2	% 3.9	% 3.2	%
Net income	8.9	% 5.4	% 6.6	% 5.3	%
Number of retail stores at end of period:					
Carter's	398	351	398	351	
OshKosh	167	176	167	176	
International	79	64	79	64	
Total	644	591	644	591	

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

Three and nine-month periods ended September 29, 2012 compared to the three and nine-month periods ended October 1, 2011

CONSOLIDATED NET SALES

In the third quarter of fiscal 2012, consolidated net sales increased \$29.0 million, or 4.5%, to \$668.7 million, which reflects growth in the Carter's retail and international segments. Consolidated net sales in the third quarter of fiscal 2012 include \$5.3 million in off-price channel sales, compared to \$19.0 million in the third quarter of fiscal 2011.

In the first nine months of fiscal 2012, consolidated net sales increased \$189.4 million, or 12.6%, to \$1.7 billion, which reflects the effect of the acquisition of Bonnie Togs and growth across all segments. Consolidated net sales for the first nine months of fiscal 2012 include \$31.7 million in off-price channel sales, compared to \$67.0 million in the first nine months of fiscal 2011.

(dollars in thousands)	For the three-month periods ended				For the nine-month periods ended				
	September 29, 2012	% of Total	October 1, 2011	% of Total	September 29, 2012	% of Total	October 1, 2011	% of Total	
Net sales:									
Carter's Wholesale	\$275,577	41.2 %	\$288,775	45.1 %	\$719,585	42.5 %	\$703,028	46.7 %	
Carter's Retail	217,299	32.5 %	184,498	28.9 %	563,764	33.3 %	465,281	31.0 %	
Total Carter's	492,876	73.7 %	473,273	74.0 %	1,283,349	75.8 %	1,168,309	77.7 %	
OshKosh Retail	78,070	11.7 %	80,472	12.6 %	194,359	11.5 %	191,578	12.7 %	
OshKosh Wholesale	28,276	4.2 %	26,472	4.1 %	61,339	3.6 %	61,248	4.1 %	
Total OshKosh	106,346	15.9 %	106,944	16.7 %	255,698	15.1 %	252,826	16.8 %	
International	69,435	10.4 %	59,400	9.3 %	153,434	9.1 %	81,970	5.5 %	
Total net sales	\$668,657	100.0 %	\$639,617	100.0 %	\$1,692,481	100.0 %	\$1,503,105	100.0 %	

CARTER'S WHOLESALE SALES

Carter's wholesale sales decreased \$13.2 million, or 4.6%, in the third quarter of fiscal 2012 to \$275.6 million. This decline was due to a 8% decrease in units shipped, partially offset by a 4% increase in average price per unit as compared to the third quarter of fiscal 2011. The decrease in units shipped was primarily due to a decrease in shipments in the off-price channel, as well as shipments of our Just One You product offerings due to the timing of product launches. The increase in average price per unit was driven by price increases on our Child of Mine and Just One You product offerings, as well as in the off-price channel.

Carter's wholesale sales increased \$16.6 million, or 2.4%, in the first nine months of fiscal 2012 to \$719.6 million. This growth was primarily driven by a 7% increase in average price per unit, partially offset by a 4% decrease in units shipped as compared to the first nine months of fiscal 2011. The increase in average price per unit was driven by price increases across our product offerings and lower levels of off-price channel sales. The decrease in units shipped was primarily due to the decrease in shipments in the off-price channel as well as shipments of our Just One You product

offerings, partially offset by strong demand for our Child of Mine product offerings.

CARTER'S RETAIL SALES

Carter's retail store sales increased \$32.8 million, or 17.8%, in the third quarter of fiscal 2012 to \$217.3 million. The increase was driven by incremental sales of \$18.7 million generated by new store openings, \$12.1 million generated by eCommerce sales, and a comparable store sales increase of \$4.3 million, or 2.7%, partially offset by the impact of store closings of \$2.4 million. On a comparable store basis, number of transactions increased 1.4% and the average transaction value increased 1.3%. The average transaction value increased due to higher average unit retail ("AUR") prices, reflecting strong product performance, successful pricing and promotional strategies, and improved inventory management.

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

Carter's retail store sales increased \$98.5 million, or 21.2%, in the first nine months of fiscal 2012 to \$563.8 million. The increase was driven by incremental sales of \$53.5 million generated by new store openings, \$35.7 million generated by eCommerce sales, and a comparable store sales increase of \$14.1 million, or 3.4%, partially offset by the impact of store closings of \$4.8 million. On a comparable store basis, the average transaction value increased 4.0% principally due to higher AUR prices.

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 last full fiscal month of operations.

During the third quarter of fiscal 2012, the Company opened 15 Carter's retail stores and closed two stores. During the first nine months of fiscal 2012, the Company opened 47 Carter's stores and closed eight stores. There were a total of 398 Carter's retail stores as of September 29, 2012. In total, the Company plans to open approximately 63 and close nine Carter's retail stores during fiscal 2012.

OSHKOSH RETAIL SALES

OshKosh retail store sales decreased \$2.4 million, or 3.0%, in the third quarter of fiscal 2012 to \$78.1 million. The decrease reflects the impact of store closings of \$3.2 million and a comparable store sales decline of \$3.1 million, or 4.3%, partially offset by incremental sales of \$3.0 million generated by eCommerce sales and incremental sales of \$0.9 million generated by new store openings. On a comparable store basis, transactions decreased 3.7% and average transactions declined by 0.6%. The decrease in the number of transactions reflected a decline in traffic.

OshKosh retail store sales increased \$2.8 million, or 1.5%, in the first nine months of fiscal 2012 to \$194.4 million. The increase reflects incremental sales of \$9.0 million generated by eCommerce sales, incremental sales of \$1.9 million generated by new store openings, partially offset by the impact of store closings of \$7.8 million and a comparable store sales decrease of \$0.3 million. On a comparable store basis, the average transaction value increased 3.8% as a result of higher AUR prices, and the number of transactions decreased 3.8% due to a decline in traffic. The increase in AUR reflects strong product performance, successful pricing and promotional strategies, and improved inventory management.

During the third quarter and first nine months of fiscal 2012, the Company opened two and three OshKosh retail stores, respectively. In the third quarter and first nine months of fiscal 2012, the Company closed one and six OshKosh retail stores, respectively. There were a total of 167 OshKosh retail stores as of September 29, 2012. In total, the Company plans to open approximately eight and close 13 OshKosh retail stores during fiscal 2012.

OSHKOSH WHOLESALE SALES

OshKosh wholesale sales increased \$1.8 million, or 6.8%, in the third quarter of fiscal 2012 to \$28.3 million. This increase reflects an 8% increase in average price per unit, partially offset by a 1% decrease in units shipped, as compared to the third quarter of fiscal 2011.

OshKosh wholesale sales increased \$0.1 million, or 0.1%, in the first nine months of fiscal 2012 to \$61.3 million. This increase was driven by a 14% increase in average price per unit, partially offset by a 12% decrease in units shipped, as

compared to the first nine months of fiscal 2011.

The increases in average price per unit primarily reflect price increases on our product offerings sold within this segment as compared to the third quarter and first nine months of fiscal 2011. The decrease in units shipped during the third quarter and first nine months of fiscal 2012 reflects a decrease in shipments in the off-price channel.

INTERNATIONAL SALES

Our international sales include our Canadian retail and wholesale operations, and international wholesale sales. International sales increased \$10.0 million, or 16.9%, in the third quarter of fiscal 2012 to \$69.4 million. Our international retail sales increased \$7.8 million, or 25.2%, to \$38.8 million, driven by incremental sales of \$6.4 million from new store

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

openings, \$1.1 million generated by incremental eCommerce sales, and a comparable store sales increase of \$0.3 million, or 1.1%. In addition, international wholesale sales increased \$2.2 million, or 7.9%, to \$30.6 million, driven by strong sales in Mexico and Central and South America.

International sales increased \$71.5 million, or 87.2%, in the first nine months of fiscal 2012 to \$153.4 million. Our international retail sales increased \$58.8 million, or 189.7%, to \$89.8 million, reflecting three quarters of sales in fiscal 2012 as compared to one quarter in fiscal 2011 and \$1.5 million generated by incremental eCommerce sales. In addition, international wholesale sales increased \$12.7 million, or 24.8%, to \$63.6 million, driven by strong sales in Mexico, Japan, and Central & South America and three quarters of Canadian wholesale sales in fiscal 2012 as compared to one quarter in fiscal 2011.

During the third quarter of fiscal 2012, the Company opened six retail stores in Canada. During the first nine months of fiscal 2012, the Company opened 14 retail stores in Canada. There were a total of 79 retail stores in Canada as of September 29, 2012. In fiscal 2012, the Company plans to open a total of 18 retail stores in Canada and anticipates no store closures.

GROSS PROFIT

Our gross profit increased \$78.0 million, or 40.6%, to \$270.1 million in the third quarter of fiscal 2012. Gross margin increased from 30.0% in the third quarter of fiscal 2011 to 40.4% in the third quarter of fiscal 2012. During the third quarter of fiscal 2012, the Company's gross margins were favorably affected by a decline in product costs of approximately \$41 million and by higher prices.

Our gross profit increased \$162.8 million, or 33.6%, to \$648.1 million in the first nine months of fiscal 2012. Gross margin increased from 32.3% in the first nine months of fiscal 2011 to 38.3% in the first nine months of fiscal 2012. The first nine months of fiscal 2012 were favorably affected by higher prices.

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.

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES

Selling, general, and administrative expenses in the third quarter of fiscal 2012 increased \$39.3 million, or 27.0%, to \$185.2 million. As a percentage of net sales, selling, general, and administrative expenses increased from 22.8% to 27.7% in the third quarter of fiscal 2012.

The increase in selling, general, and administrative expenses as a percentage of net sales reflects:

\$9.5 million in incremental domestic and international retail expenses, primarily due to new store growth;

\$6.9 million in higher provisions for performance-based compensation;

\$4.5 million in incremental operating expenses associated with the growth of the eCommerce business;

\$3.5 million in incremental marketing expenses, primarily related to branding initiatives; and

\$2.7 million in higher distribution and freight expenses.

Selling, general, and administrative expenses in the first nine months of fiscal 2012 increased \$110.3 million, or 28.9%, to \$491.2 million. As a percentage of net sales, selling, general, and administrative expenses increased from 25.3% to 29.0% in the first nine months of fiscal 2012.

The increase in selling, general, and administrative expenses as a percentage of net sales reflects:

\$23.5 million in incremental domestic retail expenses, primarily due to new store growth;

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

\$19.4 million in higher international retail store expenses, reflecting nine months of expenses in fiscal 2012, as compared to one quarter of expenses in fiscal 2011;

\$15.8 million in higher provisions for performance-based compensation;

\$13.4 million in incremental operating expenses associated with the growth of the eCommerce business;

\$6.7 million marketing expenses primarily related to branding initiatives; and

Partially offsetting these increases were:

\$2.3 million in professional service fees recorded in the first nine months of fiscal 2011 in connection with our Bonnie Togs acquisition.

ROYALTY INCOME

We license the use of our Carter's, Just One You, Child of Mine, OshKosh B'gosh, OshKosh, Genuine Kids from OshKosh, and Precious Firsts brand names. Royalty income from these brands in the third quarter of fiscal 2012 was approximately \$10.5 million (including \$1.8 million of international royalty income), consistent with the third quarter of fiscal 2011.

Royalty income from these brands in the first nine months of fiscal 2012 was approximately \$26.7 million (including \$5.0 million of international royalty income), a decrease of \$1.4 million, or 4.9%, as compared to the first nine months of fiscal 2011. The decrease was primarily related to the absence of international royalty income in the first nine months of fiscal 2012 from our former licensee, Bonnie Togs which was acquired in June 2011, partially offset by increased sales from Child of Mine brand licensees.

OPERATING INCOME

Operating income increased \$38.6 million, or 68.0%, to \$95.4 million in the third quarter of fiscal 2012. Operating income increased \$51.2 million, or 38.7%, to \$183.6 million in the first nine months of fiscal 2012 due to the factors described above.

INTEREST EXPENSE, NET

Interest expense of \$1.7 million in the third quarter of fiscal 2012 was comparable to interest expense in the third quarter of fiscal 2011. Weighted-average borrowings for the third quarter of fiscal 2012 were \$186.0 million at an effective interest rate of 3.70%, including amortization of debt issuance costs, as compared to weighted-average borrowings for the third quarter of fiscal 2011 of \$236.0 million at an effective interest rate of 3.15%, including amortization of debt issuance costs.

Interest expense in the first nine months of fiscal 2012 increased \$0.1 million, or 2.0%, to \$5.4 million, compared to the first nine months of fiscal 2011. Weighted-average borrowings for the first nine months of fiscal 2012 were \$218.5 million at an effective interest rate of 3.35%, including amortization of debt issuance costs, as compared to weighted-average borrowings for the first nine months of fiscal 2011 of \$236.0 million at an effective interest rate of 3.19%, including amortization of debt issuance costs.

FOREIGN CURRENCY (GAIN) LOSS

During both the third quarter and first nine months of fiscal 2012, the Company recorded gains of \$0.2 million related to the mark-to-market adjustment on foreign currency exchange contracts and Bonnie Togs' foreign currency denominated payables.

During the third quarter and first nine months of fiscal 2011, the Company recorded total foreign currency gains of \$0.1 million and \$0.3 million, respectively. As part of the Acquisition, the Company entered into a forward foreign currency exchange contract to reduce its risk from exchange fluctuations on the purchase price of Bonnie Togs. The contract was settled on June 30, 2011 and resulted in a gain of \$0.2 million, which was recognized in earnings in the second quarter of fiscal 2011.

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

INCOME TAXES

Our effective tax rate was 36.8% for the third quarter of fiscal 2012 as compared to 37.5% for the third quarter of fiscal 2011. The reversal of reserves for which the statute of limitations expired in the quarter increased by approximately \$0.5 million, reducing the effective tax rate for the third quarter of fiscal 2012.

Our effective tax rate was 36.9% for the first nine months of fiscal 2012 as compared to 37.8% for the first nine months of fiscal 2011. The decreases in our effective rates for both periods are primarily attributable to our Canadian operations which carry a lower overall effective tax rate, the impact of non-deductible costs associated with the 2011 Acquisition, as well as the effect of the reversal of reserves for uncertain tax positions.

NET INCOME

As a result of the factors described above, our net income for the third quarter of fiscal 2012 increased \$24.9 million, or 72.4%, to \$59.4 million as compared to \$34.4 million in the third quarter of fiscal 2011. Our net income for the first nine months of fiscal 2012 increased \$33.2 million, or 41.9%, to \$112.5 million as compared to \$79.2 million in the first nine months of fiscal 2011.

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 borrowings under our revolving credit facility, 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 September 29, 2012 were \$200.2 million compared to \$214.6 million at October 1, 2011 and \$157.8 million at December 31, 2011. The decrease of \$14.4 million, or 6.7%, as compared to October 1, 2011 primarily reflects a decrease in wholesale sales in the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011. Due to the seasonal nature of our operations, the net accounts receivable balance at September 29, 2012 is not comparable to the net accounts receivable balance at December 31, 2011.

Net inventories at September 29, 2012 were \$375.1 million compared to \$386.0 million at October 1, 2011 and \$347.2 million at December 31, 2011. The decrease of \$10.9 million, or 2.8%, as compared to October 1, 2011 is primarily due to lower product costs, timing of shipments, and improved inventory management practices. Due to the seasonal nature of our operations, net inventories at September 29, 2012 are not comparable to net inventories at December 31, 2011.

Net cash provided by operating activities for the first nine months of fiscal 2012 was \$129.2 million compared to net cash used in operating activities of \$85.8 million in the first nine months of fiscal 2011. The increase in operating cash flow primarily reflects favorable changes in net working capital and increased earnings.

We invested \$59.8 million in capital expenditures during the first nine months of fiscal 2012 compared to \$29.2 million during the first nine months of fiscal 2011. We plan to invest approximately \$90 million in capital expenditures in fiscal 2012, primarily for U.S. and international retail store openings and remodelings and in expanding our distribution capacity with the addition of the Braselton, Georgia facility.

Revolving Credit Facility

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

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

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

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

Pricing Options

The revolving credit facility provides for two pricing options for U.S. dollar facility revolving loans: (i) revolving loans on which interest is payable quarterly at a base rate equal to the highest of (x) the Federal Funds Rate plus $\frac{1}{2}$ 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 0.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 0.50% to 1.25% and (ii) revolving loans on which interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

The revolving credit facility also provides for two pricing options for multicurrency facility revolving loans denominated in U.S. dollars: (i) revolving loans on which interest is payable quarterly at a base rate equal to the highest of (x) the Federal Funds Rate plus $\frac{1}{2}$ 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., Canada Branch in Toronto as its reference rate for loans in U.S. dollars to its Canadian borrowers, or (z) the Eurodollar Rate plus 1%, plus, in each case, an applicable margin initially equal to 0.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 0.50% to 1.25% and (ii) revolving loans on which interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

In addition, the revolving credit facility provides for two pricing options for multicurrency facility revolving loans denominated in Canadian dollars: (i) revolving loans on which interest is payable quarterly at a base rate equal to the highest of (x) the rate of interest in effect for such day as publicly announced from time to time by Bank of America, N.A., Canada Branch in Toronto as its prime rate for loans in Canadian Dollars to Canadian Borrowers and (y) the rate of interest in effect for such day for Canadian dollar bankers' acceptances having a term of one month that appears on the Reuters Screen CDOR Page plus $\frac{1}{2}$ of 1%, plus, in each case, an applicable margin initially equal to 0.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 0.50% to 1.25%, and (ii) revolving loans on which interest accrues for one, two, three, six or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

The multicurrency revolving facility also provides for borrowings in currencies other than U.S. Dollars or Canadian dollars, subject to certain limitations. For such multicurrency revolving loans, interest accrues for one, two, three, six

or if, generally available, nine or twelve month interest periods (but is payable not less frequently than every three months) at a rate of interest per annum equal to an adjusted British Bankers Association LIBOR rate, plus an applicable margin initially equal to 1.75%, which may be adjusted based upon a leverage-based pricing grid ranging from 1.50% to 2.25%.

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

Covenants

The revolving credit facility contains and defines financial covenants, including a lease adjusted leverage ratio (defined as, with certain adjustments, the ratio of the Company's consolidated indebtedness plus six times rent expense to consolidated net

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

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

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

Outstanding Amount and Interest Expense

During the second quarter of fiscal 2012, the Company made total net payments on its revolving credit facility of \$50.0 million. At September 29, 2012, we had approximately \$186.0 million in revolver borrowings, exclusive of \$11.4 million of outstanding letters of credit. Weighted-average borrowings for the first nine months of fiscal 2012 were \$218.5 million at an effective interest rate of 3.35%, including amortization of debt issuance costs, as compared to weighted-average borrowings for the first nine months of fiscal 2011 of \$236.0 million at an effective interest rate of 3.19%, including amortization of debt issuance costs.

Our operating results are subject to risk from interest rate fluctuations on our revolving credit facility, which carries variable interest rates. As of September 29, 2012, our outstanding variable rate debt aggregated approximately \$186.0 million. An increase or decrease of 1% in the applicable rate would increase or decrease our annual interest cost by approximately \$1.9 million and could have an adverse effect on our net income (loss) and cash flow.

Bonnie Togs Acquisition

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

As of September 29, 2012, the Company had a discounted contingent consideration liability of approximately \$29.4 million based upon the high probability that Bonnie Togs will attain its earnings targets of which approximately \$14.4 million is included in other current liabilities and the remainder is included in other long-term liabilities, on the accompanying unaudited condensed consolidated balance sheet. The Company will continue to revalue the contingent consideration at each reporting date.

Facility Closures

In conjunction with the plan to close the Hogansville, Georgia distribution facility, the Company expects to incur closure-related charges of approximately \$0.9 million for one-time termination benefits (\$0.3 million in fiscal 2012

and \$0.6 million in fiscal 2013) and \$0.9 million in accelerated depreciation (\$0.4 million in fiscal 2012 and \$0.5 million in fiscal 2013), and other closure costs of \$1.0 million in fiscal 2013. The salvage value of this facility is estimated to be \$2.0 million.

On October 11, 2012, the Company announced plans to consolidate its retail store and financial operations currently managed in its Shelton, Connecticut facility with the Company's Atlanta, Georgia based operations. The Company expects to complete this consolidation by the end of fiscal 2013. The Company anticipates pre-tax consolidation-related expenses in the range of \$35 million to \$40 million over the next 12 to 18 months. The Company expects approximately \$34 million of those charges to be cash, consisting of approximately \$13 million of recruiting and relocation expenses, \$10 million of employee severance and other benefit costs, \$6 million of lease-related charges, and \$5 million of other associated costs. The Company

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

also expects approximately \$3 million of those charges to be non-cash accelerated depreciation expense in connection with the office consolidation.

Share Repurchases

During fiscal 2007, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company was authorized to purchase up to \$100 million of its outstanding common shares. During fiscal 2010, the Company's Board of Directors approved a share repurchase authorization, pursuant to which the Company is authorized to purchase up to an additional \$100 million of its outstanding common shares. As of August 13, 2010, the Company had repurchased outstanding shares in the amount totaling the entire \$100 million authorized by the Board of Directors on February 16, 2007.

The Company did not repurchase any shares of its common stock during the three and nine-month periods ended September 29, 2012 and October 1, 2011 pursuant to any repurchase authorization other than the shares of common stock from the Company's employees to satisfy tax withholding obligations upon vesting of restricted stock to such employees. Since inception of the repurchase program and through fiscal 2011, the Company repurchased and retired 6,658,410 shares, or approximately \$141.1 million, of its common stock at an average price of \$21.19 per share. We have reduced common stock by the par value of such shares repurchased and have deducted the remaining excess repurchase price over par value from additional paid-in capital. Future repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, other investment priorities, and other factors.

Liquidity Outlook

Based on our current outlook, we believe that cash generated from operations and available cash, together with amounts available under our revolving credit facility, 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.

EFFECTS OF INFLATION AND DEFLATION

The Company is subject to both inflationary and deflationary risks. With respect to inflation, the Company has experienced higher product costs in recent years. Although we expect product costs to decline for the remainder of the year as compared to prior year, costs are generally expected to remain at elevated levels. The Company's product costs have also in recent years been adversely affected by the devaluation of the U.S. dollar relative to certain foreign currencies. The Company has also experienced deflationary pressure on its selling prices, in part driven by intense price competition in the young children's apparel industry. Although we raised our selling prices on many of our products, we were unable to fully absorb these cost increases in recent years and our profitability was adversely 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. More of our consolidated net sales over the past five fiscal years, excluding the effect of the Acquisition in fiscal 2011, have

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.

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

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 eCommerce 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 collectability 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 customers 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 collectability. 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.

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 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 \$1.4 million and \$3.2 million in the third quarter and first nine months of fiscal 2012, respectively, and \$0.1 million and \$2.1 million in the third quarter and first nine months of fiscal 2011, respectively, as a component of selling, general, and administrative expenses on the accompanying unaudited condensed consolidated statements 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 we project, additional write-downs may be required.

Goodwill and tradename: As of September 29, 2012, we had approximately \$190.5 million in Carter's and Bonnie Togs goodwill and \$306.0 million of aggregate value related to the Carter's, OshKosh, and Bonnie Togs 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 estimated at its acquisition date, July 14, 2005, using an identical discounted cash flow analysis. The Carter's and OshKosh tradenames were determined to have indefinite lives. The Bonnie Togs tradename was also estimated using an identical discounted cash flow analysis at the time of acquisition on June 30, 2011. The Bonnie Togs tradename was determined to have a definite life and is being amortized over two years.

The carrying values of the goodwill and indefinite lived 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

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

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.

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, 401(k), 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.

Foreign currency: The functional currency of the Company's foreign operations is the local currency. Assets and liabilities are translated into U.S. dollars using the current exchange rates in effect at the balance sheet date, while revenues and expenses are translated at the average exchange rates for the period. The resulting translation adjustments are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity.

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

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

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.

The most significant assumption used to determine the Company's projected benefit obligation under its 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 8, "Employee Benefits Plans," to our audited consolidated financial statements, in our most recently filed Annual Report in Form 10-K for further details on rates and assumptions.

Stock-based compensation arrangements: The Company accounts for stock-based compensation in accordance with the fair value recognition provisions of accounting guidance on share-based payments. The Company adopted this guidance using the modified prospective application method of transition. The Company uses 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. The Company uses 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 – The Company does not have plans to pay dividends in the foreseeable future. An increase in the dividend yield will decrease compensation expense.

Forfeitures – The Company estimates 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 unaudited condensed consolidated statements of operations.

The Company accounts for its performance-based awards in accordance with accounting guidance on share-based payments and records 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. The Company reassesses the probability of vesting at each reporting period for awards with performance criteria and adjusts stock-based compensation expense based on its probability assessment.

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

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 2012 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. 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 approximately 15 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.

Transactions by our Canadian subsidiary may be denominated in a currency other than the entity's functional currency, which is the Canadian dollar. Fluctuations in exchange rates, primarily between the United States dollar and the Canadian dollar, may affect our results of operations, financial position, and cash flows. We employ foreign exchange contracts to hedge foreign currency exchange rate risk associated with the procurement of U.S. dollar denominated finished goods destined for the Canadian market. These foreign exchange contracts are marked to market at the end of each reporting period, which could result in earnings volatility.

Our operating results are subject to risk from interest rate fluctuations on our revolving credit facility, which carries variable interest rates. As of September 29, 2012, our outstanding variable rate debt aggregated approximately \$186.0 million. Therefore, an increase or decrease of 1% in the applicable rate would increase or decrease our annual interest cost by \$1.9 million 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.

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 (the "Exchange Act")) 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 are effective as of September 29, 2012.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over

financial reporting.

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PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS:

The Company is subject to various 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 both the third quarter and first nine months of fiscal 2012, we derived approximately 36% of our consolidated net sales from our top eight customers. No one customer represented 10% or more of our consolidated sales in the third quarter and first nine months of 2012. 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 relationship 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 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 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. Further, 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 involved in additional litigation matters in the future. As previously reported, beginning in the fourth quarter of fiscal 2009, the SEC and the United States Attorney's Office began conducting investigations, with which the Company cooperated, related to customer margin support provided by the Company, including undisclosed margin support commitments and related matters. In December 2010, the Company and the SEC entered into a non-prosecution agreement pursuant to which the SEC agreed not to charge the Company with any violations of the federal securities laws, commence any enforcement action against the Company, or require the Company to

pay any financial penalties in connection with the SEC's investigation of customer margin support provided by the Company, conditioned upon the Company's continued cooperation with the SEC's investigation and with any related enforcement proceedings. The Company has incurred, and expects to continue to incur, substantial expenses for legal services due to the SEC and United States Attorney's Office investigations and 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 expects to bear additional costs pursuant to its advancement and potential indemnification obligations to directors and officers under our organizational documents and Delaware law in connection with proceedings related to these matters. Our insurance may not provide coverage to offset such costs. At this point, the Company is unable to predict the duration, costs, scope or result of these matters.

The Company's databases containing personal information of our retail and eCommerce 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.

Increases in production costs and deflationary pressures on our selling prices may adversely affect our results.

The Company's product costs are subject to fluctuations in component costs such as cotton, labor, fuel, and transportation. In recent years, we have experienced increased costs of these components and have also had higher costs for foreign sourced products as a result of the devaluation of the U.S. dollar relative to certain foreign currencies. Although we expect product costs to decline for the remainder of this year as compared to last year, we expect product costs will generally remain at elevated levels. While we raised our selling prices on many of our products, we have been unable to fully absorb the cost increases in recent years and our profitability has been adversely impacted. In recent years, the Company has also experienced deflationary pressure on its selling prices, in part driven by intense price competition in the young children's apparel industry. If future product cost increases are more than anticipated and if we are unable to offset such cost increases through selling price increases or otherwise, our profitability could be adversely affected.

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, principally, 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, capacity withholding, 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 Company's and/or its subsidiaries' functional currency and the currencies paid to 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 substantially 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.

Any significant disruption to our eCommerce business, including order acceptance and processing, order fulfillment, web-hosting, warehousing, and call center operations, could result in lost sales and could harm our brand and our reputation in the marketplace.

The operation of our eCommerce business depends on the ability to maintain the efficient and uninterrupted operation of online order-taking and fulfillment operations. We currently rely on a third party to host our eCommerce website, process and manage web orders, and operate a call center supporting our eCommerce business. Over the first nine months of fiscal 2012, we transitioned fulfillment services in house and expect to transition additional services through 2013. Any significant disruption in the operations of our eCommerce business or in our ability to transition third party services effectively could result in lost sales and could harm our brand and our reputation in the marketplace.

The loss of a sourcing agent could negatively impact our ability to timely deliver our inventory supply and disrupt our business, which may adversely affect our operating results.

One sourcing agent currently manages approximately 80% of our inventory purchases. Although we believe that other buying agents could be retained, or we could procure some of the inventory directly, the loss of this buying agent could delay our ability to timely receive inventory supply and disrupt our business, which could result in a material adverse effect on our operating results.

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 businesses include private label product offerings, Disney, and Gerber. 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. 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 United States and Canada. 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 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 September 29, 2012, the Company had goodwill of \$136.6 million for Carter's and \$53.9 million for Bonnie Togs, and tradename assets of \$220.2 million for the Carter's brand, \$85.5 million for the OshKosh brand, and \$0.2 million for the Bonnie Togs brand on its unaudited condensed 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 impairment of the remaining asset values.

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.

The consolidation of the Company's Shelton, Connecticut-based operations with our Atlanta, Georgia-based operations may adversely affect our results of operations, financial position, and cash flows more than anticipated.

Actual charges related to the previously announced consolidation could be greater than estimated. The office consolidation may not be completed during the expected time frame or at all due to the delay in securing, or inability to secure, suitable facilities or other reasons. If we do not effectively transition our workforce by identifying and relocating key positions and, hiring qualified candidates in Georgia, we could experience business disruption due to a loss of historical knowledge and a lack of business continuity. We may not be able to achieve all or any of the expected benefits of the office consolidation as a result of any such business disruption or other factors. Disruption to our operations as a result of the consolidation could adversely affect our operations and financial results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS:

Share Repurchases

The following table provides information about shares acquired from employees during the third quarter of fiscal 2012 to satisfy the required withholding of taxes in connection with the vesting of restricted stock:

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	Approximate dollar value of shares that may yet be purchased under the plans or programs
July 1, 2012 through July 28, 2012	2,696	\$52.60	—	Not applicable
July 29, 2012 through August 25, 2012	4,712	\$51.88	—	Not applicable
August 26, 2012 through September 29, 2012	—	\$—	—	Not applicable
Total	7,408	\$52.14	—	Not applicable

(1) All of the shares were surrendered by our employees to satisfy required tax withholding upon the vesting of restricted stock awards.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES:

N/A

ITEM 4. MINE SAFETY DISCLOSURES:

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 : November 1, 2012

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

Date : November 1, 2012

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