

CARTERS INC
Form 10-Q
July 27, 2016

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 JULY 2, 2016 OR

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

Commission file number:

001-31829

CARTER'S, INC.

(Exact name of Registrant as specified in its charter)

Delaware 13-3912933

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

Phipps Tower

3438 Peachtree Road NE, Suite 1800

Atlanta, Georgia 30326

(Address of principal executive offices, including zip code)

(678) 791-1000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically 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.

	Outstanding Shares at July 22, 2016
Common Stock	
Common stock, par value \$0.01 per share	50,060,231

CARTER'S, INC.
INDEX

	Page
<u>Part I. Financial Information</u>	
<u>Item 1 Financial Statements</u>	
Unaudited Condensed Consolidated Balance Sheets as of July 2, 2016, January 2, 2016 and July 4, 2015	<u>1</u>
Unaudited Condensed Consolidated Statements of Operations for the fiscal quarter and two fiscal quarters ended July 2, 2016 and July 4, 2015	<u>2</u>
Unaudited Condensed Consolidated Statements of Comprehensive Income for the fiscal quarter and two fiscal quarters ended July 2, 2016 and July 4, 2015	<u>3</u>
Unaudited Condensed Consolidated Statement of Changes in Stockholders' Equity for the two fiscal quarters ended July 2, 2016	<u>4</u>
Unaudited Condensed Consolidated Statements of Cash Flows for the two fiscal quarters ended July 2, 2016 and July 4, 2015	<u>5</u>
<u>Notes to the Unaudited Condensed Consolidated Financial Statements</u>	<u>6</u>
<u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
<u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u>	<u>43</u>
<u>Item 4 Controls and Procedures</u>	<u>44</u>
<u>Part II. Other Information</u>	
<u>Item 1 Legal Proceedings</u>	<u>45</u>
<u>Item 1A Risk Factors</u>	<u>45</u>
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>46</u>
<u>Item 3 Defaults upon Senior Securities</u>	<u>47</u>
<u>Item 4 Mine Safety Disclosures</u>	<u>47</u>
<u>Item 5 Other Information</u>	<u>47</u>
<u>Item 6 Exhibits</u>	<u>47</u>
<u>Signatures</u>	<u>48</u>
<u>Certifications</u>	

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARTER'S, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share data)

(unaudited)

	July 2, 2016	January 2, 2016	July 4, 2015
ASSETS			
Current assets:			
Cash and cash equivalents	\$205,080	\$381,209	\$244,301
Accounts receivable, net	150,633	207,570	157,145
Finished goods inventories	587,434	469,934	544,256
Prepaid expenses and other current assets	46,189	37,815	47,639
Deferred income taxes	32,816	34,080	31,871
Total current assets	1,022,152	1,130,608	1,025,212
Property, plant, and equipment, net of accumulated depreciation of \$317,580, \$290,636, and \$263,580, respectively	386,034	371,704	353,138
Tradenames, net	309,017	310,848	312,836
Goodwill	177,540	174,874	178,753
Other assets	17,749	15,620	13,759
Total assets	\$1,912,492	\$2,003,654	\$1,883,698
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$190,366	\$157,648	\$145,809
Other current liabilities	80,595	105,070	76,451
Total current liabilities	270,961	262,718	222,260
Long-term debt, net	580,678	578,972	580,427
Deferred income taxes	128,682	128,838	119,230
Other long-term liabilities	165,469	158,075	158,842
Total liabilities	\$1,145,790	\$1,128,603	\$1,080,759
Commitments and contingencies - Note 13			
Stockholders' equity:			
Preferred stock; par value \$.01 per share; 100,000 shares authorized; none issued or outstanding at July 2, 2016, January 2, 2016, and July 4, 2015	—	—	—
Common stock, voting; par value \$.01 per share; 150,000,000 shares authorized; 50,194,955, 51,764,309, and 52,331,208 shares issued and outstanding at July 2, 2016, January 2, 2016 and July 4, 2015, respectively	502	518	523
Additional paid-in capital	—	—	—
Accumulated other comprehensive loss	(30,533)	(36,367)	(29,275)
Retained earnings	796,733	910,900	831,691
Total stockholders' equity	766,702	875,051	802,939
Total liabilities and stockholders' equity	\$1,912,492	\$2,003,654	\$1,883,698

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)

	Fiscal quarter ended		Two fiscal quarters ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Net sales	\$639,471	\$612,765	\$1,363,556	\$1,297,529
Cost of goods sold	357,289	349,870	770,445	750,582
Gross profit	282,182	262,895	593,111	546,947
Selling, general, and administrative expenses	228,464	209,296	457,460	420,479
Royalty income	(9,525)	(8,353)	(20,600)	(19,989)
Operating income	63,243	61,952	156,251	146,457
Interest expense	6,803	6,935	13,542	13,627
Interest income	(178)	(157)	(385)	(294)
Other expense (income), net	516	(1,900)	3,709	62
Income before income taxes	56,102	57,074	139,385	133,062
Provision for income taxes	19,904	20,969	49,207	47,165
Net income	\$36,198	\$36,105	\$90,178	\$85,897
Basic net income per common share	\$0.72	\$0.69	\$1.77	\$1.63
Diluted net income per common share	\$0.71	\$0.68	\$1.75	\$1.62
Dividend declared and paid per common share	\$0.33	\$0.22	\$0.66	\$0.44

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Fiscal quarter ended		Two fiscal quarters ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Net income	\$36,198	\$36,105	\$90,178	\$85,897
Other comprehensive income (loss):				
Foreign currency translation adjustments	548	(244)	5,834	(6,238)
Comprehensive income	\$36,746	\$35,861	\$96,012	\$79,659

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(amounts in thousands, except share amounts)

(unaudited)

	Common stock - shares	Common stock - \$	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total stockholders' equity
Balance at January 2, 2016	51,764,309	\$ 518	\$ —	\$ (36,367)	\$ 910,900	\$ 875,051
Income tax benefit from stock-based compensation	—	—	3,684	—	—	3,684
Exercise of stock options	118,000	1	5,100	—	—	5,101
Withholdings from vesting of restricted stock	(89,892)	(1)	(8,507)	—	—	(8,508)
Restricted stock activity	164,073	2	(2)	—	—	—
Stock-based compensation expense	—	—	8,086	—	—	8,086
Issuance of common stock	10,312	—	1,164	—	—	1,164
Repurchase of common stock	(1,771,847)	(18)	(9,525)	—	(170,666)	(180,209)
Cash dividends declared and paid	—	—	—	—	(33,679)	(33,679)
Comprehensive income	—	—	—	5,834	90,178	96,012
Balance at July 2, 2016	50,194,955	\$ 502	\$ —	\$ (30,533)	\$ 796,733	\$ 766,702

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Two fiscal quarters ended July 2, 2016	July 4, 2015
Cash flows from operating activities:		
Net income	\$ 90,178	\$ 85,897
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	34,916	30,338
Amortization of tradenames	1,831	4,429
Accretion of contingent consideration	—	809
Amortization of debt issuance costs	725	678
Non-cash stock-based compensation expense	9,250	9,560
Unrealized foreign currency loss, net	3,130	84
Income tax benefit from stock-based compensation	(3,684)	(6,890)
Loss on disposal of property, plant, and equipment	133	90
Deferred income taxes	1,258	1,886
Effect of changes in operating assets and liabilities:		
Accounts receivable, net	57,229	28,649
Finished goods inventories	(114,817)	(103,379)
Prepaid expenses and other assets	(12,643)	(14,244)
Accounts payable and other liabilities	18,093	(10,775)
Net cash provided by operating activities	85,599	27,132
Cash flows from investing activities:		

Edgar Filing: CARTERS INC - Form 10-Q

Capital expenditures	(49,698)	(50,284)
Proceeds from sale of property, plant, and equipment	193		43	
Net cash used in investing activities	(49,505)	(50,241)
Cash flows from financing activities:				
Borrowings under secured revolving credit facility	—		20,349	
Payments on secured revolving credit facility	—		(20,000)
Repurchase of common stock	(180,209)	(48,894)
Dividends paid	(33,679)	(23,143)
Income tax benefit from stock-based compensation	3,684		6,890	
Withholdings from vesting of restricted stock	(8,508)	(12,377)
Proceeds from exercise of stock options	5,101		4,560	
Net cash used in financing activities	(213,611)	(72,615)
Effect of exchange rate changes on cash and cash equivalents	1,388		(613)
Net decrease in cash and cash equivalents	(176,129)	(96,337)
Cash and cash equivalents, beginning of period	381,209		340,638	
Cash and cash equivalents, end of period	\$ 205,080		\$ 244,301	

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 – THE COMPANY

Carter's, Inc. and its wholly owned subsidiaries (collectively, the "Company," "its," "us" and "our") design, source, and market branded childrenswear under the Carter's, Child of Mine, Just One You, Precious Firsts, OshKosh, and other brands. The Company's products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic and international retailers and for the Company's own retail stores and websites that market its brand name merchandise and other licensed products manufactured by other companies. As of July 2, 2016, the Company operated 624 Carter's stores in the United States, 262 OshKosh stores in the United States, and 150 stores in Canada.

NOTE 2 – BASIS OF PREPARATION AND ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

The accompanying unaudited condensed consolidated financial statements include the accounts of Carter's, Inc. and its wholly owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). All intercompany transactions and balances have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all normal and recurring adjustments necessary to state fairly the consolidated financial condition, results of operations, comprehensive income, statement of stockholders' equity, and cash flows of the Company for the interim periods presented. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the fiscal quarter and two fiscal quarters ended July 2, 2016 are not necessarily indicative of the results that may be expected for the 2016 fiscal year ending December 31, 2016.

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

The accompanying condensed consolidated balance sheet as of January 2, 2016 was derived from the Company's audited consolidated financial statements included in its most recently filed Annual Report on Form 10-K. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC and the instructions to Form 10-Q.

The accounting policies the Company follows are set forth in its most recently filed Annual Report on Form 10-K. There have been no material subsequent changes to these accounting policies, except as noted below for new accounting pronouncements adopted at the beginning of fiscal 2016.

Adoption of New Accounting Pronouncements At the Beginning of Fiscal 2016

At the beginning of fiscal 2016, the Company adopted the following Accounting Standards Updates ("ASU"): ASU No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"); ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"); and ASU No. 2015-04, Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets ("ASU 2015-04"). ASU 2015-05

The Company prospectively adopted the provisions of ASU No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement at the beginning of fiscal 2016, as it relates to the accounting for fees paid in connection with arrangements with cloud-based software providers. Under the new guidance, unless a software arrangement includes specific elements enabling customers to possess and operate software on platforms other than those offered by the cloud-based provider, the costs of such arrangements are accounted for as an operating expense in the period in which such costs are incurred. The adoption of this guidance did not have a material effect on the Company's financial position, results of operations, or cash flows.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the Company's adoption of ASU 2015-03, refer to Note 6, Long-Term Debt, accompanying the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q. The Company adopted this guidance effective at the beginning of fiscal 2016 and the provisions have been applied to each prior period presented for comparative purposes.

For the Company's adoption of ASU 2015-04, refer to Note 8, Employee Benefit Plans, accompanying the unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q.

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE LOSS

The components, net of applicable income taxes, of accumulated other comprehensive loss consisted of the following:

(dollars in thousands)	July 2, 2016	January 2, 2016	July 4, 2015
Cumulative foreign currency translation adjustments	\$(23,752)	\$(29,586)	\$(21,635)
Pension and post-retirement liability adjustments	(6,781)	(6,781)	(7,640)
Total accumulated other comprehensive loss	\$(30,533)	\$(36,367)	\$(29,275)

Changes in accumulated other comprehensive loss for the second quarter and first two quarters of fiscal 2016 consisted of additional gains of \$0.5 million and additional gains of \$5.8 million for foreign currency translation adjustments, respectively. Changes in accumulated other comprehensive loss for the second quarter and first two quarters of fiscal 2015 consisted of additional losses of \$0.2 million and \$6.2 million for foreign currency translation adjustments, respectively. During the first and second quarters of both fiscal 2016 and fiscal 2015, no amounts were reclassified from accumulated other comprehensive loss to the statement of operations.

NOTE 4 – GOODWILL AND TRADENAMES INTANGIBLE ASSETS

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

(dollars in thousands)	Weighted-average useful life	July 2, 2016			January 2, 2016		
		Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount
Carter's goodwill	Indefinite	\$136,570	\$ —	\$136,570	\$136,570	\$ —	\$136,570
Canadian acquisition	Indefinite	40,970	—	40,970	38,304	—	38,304
Total goodwill		\$177,540	\$ —	\$177,540	\$174,874	\$ —	\$174,874
Carter's tradename	Indefinite	\$220,233	\$ —	\$220,233	\$220,233	\$ —	\$220,233
OshKosh tradename	Indefinite	85,500	—	85,500	85,500	—	85,500
Other tradenames	2-20 years	42,022	38,738	3,284	41,992	36,877	5,115
Total tradenames		\$347,755	\$ 38,738	\$309,017	\$347,725	\$ 36,877	\$310,848
		July 4, 2015					
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount			
Carter's goodwill	Indefinite	\$136,570	\$ —	\$136,570			
Canadian acquisition	Indefinite	42,183	—	42,183			
Total goodwill		\$178,753	\$ —	\$178,753			

Edgar Filing: CARTERS INC - Form 10-Q

Carter's tradename	Indefinite	\$220,233	\$ —	\$220,233
OshKosh tradename	Indefinite	85,500	—	85,500
Other tradenames	2-20 years	42,036	34,933	7,103
Total tradenames		\$347,769	\$ 34,933	\$312,836

7

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The changes in the carrying values between the comparative periods for goodwill related to the Company's 2011 acquisition of its Canadian business (Bonnie Togs) were solely due to fluctuations in the foreign currency exchange rates between the Canadian and U.S. dollar that were used in the remeasurement process for preparing the Company's consolidated financial statements. The portion of the changes in the carrying values for other trademarks, including the related accumulated amortization, that was not attributable to amortization expense was also impacted by these same foreign currency exchange rate fluctuations.

The Company recorded approximately \$0.8 million and \$1.8 million in amortization expense for the fiscal quarter and two fiscal quarters ended July 2, 2016, respectively, and approximately \$2.1 million and \$4.4 million in amortization expense for the fiscal quarter and two fiscal quarters ended July 4, 2015, respectively. At July 2, 2016, the estimated future amortization expense for these assets is approximately \$0.1 million for the remainder of fiscal 2016, \$0.2 million for fiscal 2017, \$0.2 million for each of fiscal year 2018, 2019 and 2020, and \$2.5 million thereafter.

NOTE 5 – COMMON STOCK

SHARE REPURCHASES

In the second quarter of fiscal 2013, the Company's Board of Directors authorized the repurchase of shares of the Company's stock in an amount up to \$300 million, inclusive of amounts remaining under previous authorizations. In the third quarter of fiscal 2013, the Board approved an additional \$400 million accelerated share repurchase authorization, which has been completed. On February 24, 2016, the Company's Board of Directors authorized a new \$500 million share repurchase program in addition to any amounts remaining under previous authorizations. The total remaining capacity under the outstanding repurchase authorizations as of July 2, 2016 was approximately \$394.6 million, based on settled repurchase transactions. The authorizations have no expiration date.

Open Market Repurchases

The Company repurchased and retired shares in open market transactions in the following amounts for the fiscal periods indicated:

	Fiscal quarter ended		Two fiscal quarters ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Number of shares repurchased	1,049,483	346,325	1,771,847	504,225
Aggregate cost of shares repurchased -(dollars in thousands)	\$ 108,648	\$ 34,773	\$ 180,209	\$ 48,894
Average price per share	\$ 103.52	\$ 100.40	\$ 101.71	\$ 96.97

Future repurchases may occur from time to time in the open market, in privately 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.

DIVIDENDS

In the second fiscal quarter and two fiscal quarters ended July 2, 2016, the Company paid cash dividends per share of \$0.33 and \$0.66, respectively. In the second fiscal quarter and two fiscal quarters ended July 4, 2015, the Company

paid cash dividends per share of \$0.22 and \$0.44, respectively. Future declarations of dividends and the establishment of future record and payment dates are at the discretion of the Company's Board of Directors and based on a number of factors, including the Company's future financial performance and other investment priorities.

Provisions in the indenture governing the senior notes of The William Carter Company ("TWCC"), a 100% owned subsidiary of the Company, and in TWCC's secured revolving credit facility could have the effect of restricting the Company's ability to

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

pay future cash dividends on, or make future repurchases of, its common stock. Provisions related to the indenture governing the senior notes are described in the Company's Annual Report on Form 10-K for the 2015 fiscal year ended January 2, 2016.

NOTE 6 – LONG-TERM DEBT

Long-term debt consisted of the following:

(dollars in thousands)	July 2, 2016	January 2, 2016	July 4, 2015
Senior notes at amounts repayable	\$400,000	\$400,000	\$400,000
Less unamortized issuance-related costs for senior notes	(5,036)	(5,459)	(5,871)
Senior notes, net	394,964	394,541	394,129
Secured revolving credit facility	185,714	184,431	186,298
Total long-term debt, net	\$580,678	\$578,972	\$580,427

In the first quarter of fiscal 2015, the Company replaced \$20.0 million of outstanding borrowings under the then-existing secured revolving credit facility with CAD 25.5 million of borrowings, which approximated \$20.3 million. This transaction is reflected on the Company's consolidated statement of cash flows.

Secured Revolving Credit Facility

As previously disclosed in the Company's most recent Annual Report on Form 10-K for the 2015 fiscal year ended January 2, 2016, the secured revolving credit facility was amended and restated in September 2015. The aggregate principal amount of the secured revolving credit facility is \$500 million consisting of (i) a \$400 million U.S. dollar revolving credit facility (including a \$175 million sub-limit for letters of credit and a swing line sub-limit of \$50 million) available for borrowings by TWCC and (ii) a \$100 million multicurrency revolving credit facility (including a \$40 million sub-limit for letters of credit and a swing line sub-limit of \$15 million) available for borrowings by TWCC and certain other subsidiaries of TWCC in U.S. dollars, Canadian dollars, Euros, Pounds Sterling, or other currencies agreed to by the applicable lenders. The secured revolving credit facility also provides for incremental facilities in an aggregate amount not to exceed \$250 million, either in the form of a commitment increase under the existing revolving credit facility or the incurrence of one or more tranches of term loans (with the aggregate U.S. dollar amount available to the Company not to exceed \$200 million and the aggregate multicurrency amount available not to exceed \$50 million). The Company's secured revolving credit facility matures September 16, 2020.

As of July 2, 2016, the Company had approximately \$185.7 million in outstanding borrowings under its secured revolving credit facility, exclusive of \$4.8 million of outstanding letters of credit. As of July 2, 2016, approximately \$309.4 million was available for future borrowing.

As of July 2, 2016, the interest rate margins applicable to the secured revolving credit facility were 1.375% for LIBOR (London Interbank Offered Rate) rate loans (which may be adjusted based on a leverage-based pricing grid ranging from 1.125% to 1.875%) and 0.375% for base rate loans (which may be adjusted based on a leverage-based pricing grid ranging from 0.125% to 0.875%).

Edgar Filing: CARTERS INC - Form 10-Q

As of July 2, 2016, U.S. dollar borrowings outstanding under the secured revolving credit facility accrued interest at a LIBOR rate plus the applicable base rate, which was 1.82% on that date, and Canadian dollar borrowings accrued interest at a CDOR (Canadian Dollar Offered Rate) plus the applicable base rate, which was 2.26% on that date.

As disclosed in the Company's most recent Annual Report on Form 10-K for the 2015 fiscal year ended January 2, 2016, the Company's secured revolving credit facility contains covenants, including affirmative and financial covenants. As of July 2, 2016, the Company was in compliance with the financial and other covenants under the secured revolving credit facility.

Senior Notes

9

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of July 2, 2016, TWCC had outstanding \$400 million principal amount of senior notes bearing interest at a fixed rate of 5.25% per annum and maturing on August 15, 2021. The senior notes are unsecured and are fully and unconditionally guaranteed by Carter's, Inc. and certain subsidiaries of TWCC. On the Company's consolidated balance sheet, the senior notes are reported net of certain unamortized issuance-related costs, as described in the following section.

Adoption of New Accounting Pronouncement Related to Debt Issuance Costs

The Company retrospectively adopted the provisions of Accounting Standards Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"), at the beginning of fiscal 2016, which requires that debt issuance costs be presented as a direct deduction from the carrying amount of the related debt liability, consistent with the presentation of a debt discount. Prior to the issuance of ASU 2015-03, debt issuance costs were required to be presented as deferred charge assets, separate from the related debt liability. The guidance did not change the recognition and measurement requirements for debt issuance costs. The Company reclassified \$5.0 million, \$5.5 million, and \$5.9 million of unamortized issuance-related debt costs associated with the Company's senior notes from other assets to Long-term debt, net within its consolidated balance sheets as of July 2, 2016, January 2, 2016, and July 4, 2015, respectively. Other than this balance sheet reclassification, the adoption of ASU 2015-03 did not have an impact on the Company's consolidated financial statements. Fees paid to lenders to secure revolving lines of credit continue to be presented as a deferred charge (asset) on the balance sheet.

NOTE 7 – STOCK-BASED COMPENSATION

The Company recorded stock-based compensation expense as follows:

(dollars in thousands)	Fiscal quarter ended		Two fiscal quarters ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Stock options	\$981	\$1,020	\$2,277	\$2,344
Restricted stock:				
Time-based awards	1,717	1,612	3,862	3,695
Performance-based awards	832	1,093	1,947	2,426
Stock awards	1,164	1,095	1,164	1,095
Total	\$4,694	\$4,820	\$9,250	\$9,560

NOTE 8 – EMPLOYEE BENEFIT PLANS

The Company maintains a defined contribution plan and two defined benefit plans. The two defined benefit plans include the OshKosh B'Gosh pension plan and a post-retirement life and medical plan.

OSHKOSH B'GOSH PENSION PLAN

The net periodic pension cost (benefit) included in the statement of operations was comprised of:

(dollars in thousands)	Fiscal quarter ended		Two fiscal quarters ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Interest cost	\$629	\$623	\$1,258	\$1,246
Expected return on plan assets	(676)	(785)	(1,352)	(1,570)
Recognized actuarial loss	145	161	290	322
Net periodic pension cost (benefit)	\$98	\$(1)	\$196	\$(2)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

POST-RETIREMENT LIFE AND MEDICAL PLAN

The components of post-retirement benefit expense charged to the statement of operations were as follows:

(dollars in thousands)	Fiscal		Two fiscal	
	quarter	ended	quarters	ended
	July 2,	July 4,	July 2,	July 4,
	2016	2015	2016	2015
Service cost – benefits attributed to service during the period	\$31	\$32	\$62	\$64
Interest cost on accumulated post-retirement benefit obligation	44	45	88	90
Amortization net actuarial gain	(49)	(48)	(98)	(96)
Total net periodic post-retirement benefit cost	\$26	\$29	\$52	\$58

Simplified Measurement Date for Defined Benefit Plan Assets and Obligations

The Company adopted the provisions of ASU No. 2015-04, Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets ("ASU 2015-04") at the beginning of fiscal 2016. However, the Company is not required to make any such measurements until the end of fiscal 2016. ASU 2015-04 allows employers with fiscal year ends that do not coincide with a calendar month end to make an accounting policy election to measure defined benefit plan assets and obligations as of the end of the month closest to their fiscal year end (i.e., on an alternative measurement date). An employer that makes this election must consistently apply the alternative measurement date from year to year and to all of its defined benefit plans. The Company expects to make the accounting policy election to use December 31 as the measurement date for all of its defined benefit plan assets and obligations for fiscal 2016 and subsequent years. Measurement dates for prior periods will not be impacted. Since the Company's current 52-week fiscal year will end on December 31, 2016, it will not be necessary for the Company to utilize an alternate measurement date for fiscal 2016 and thus the initial adoption of ASU 2015-04 in fiscal 2016 will have no impact on the Company's results of operations, financial condition, or cash flows.

NOTE 9 – INCOME TAXES

During the first quarters of fiscal 2016 and 2015, the IRS and various state tax authorities completed examinations of the Company's income tax returns. As a result, the Company recognized income tax benefits related to prior years of approximately \$0.4 million and \$1.8 million in the first quarters of fiscal 2016 and 2015, respectively. In most cases, the Company is no longer subject to state and local tax authority examinations for years prior to fiscal 2012.

As of July 2, 2016, the Company had gross unrecognized income tax benefits of approximately \$9.8 million, of which \$6.9 million, if ultimately recognized, may affect the Company's effective tax rate in the periods settled. The Company has recorded tax positions for which the ultimate deductibility is more likely than not, but for which there is uncertainty about the timing of such deductions.

Included in the reserves for unrecognized tax benefits at July 2, 2016 were approximately \$1.0 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 affect the annual effective tax rate for fiscal 2016 or fiscal 2017 along with the effective tax rate in the quarter in which the benefits are recognized.

The Company recognizes interest related to unrecognized tax benefits as a component of interest expense and recognizes penalties related to unrecognized tax benefits as a component of income tax expense. During the fiscal quarter and two fiscal quarters ended July 2, 2016 and the fiscal quarter and two fiscal quarters ended July 4, 2015, interest expense recorded on uncertain tax positions was not significant. The Company had approximately \$0.8 million, \$0.8 million, and \$0.9 million of interest accrued on uncertain tax positions as of July 2, 2016, January 2, 2016, and July 4, 2015, respectively.

NOTE 10 – FAIR VALUE MEASUREMENTS

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following tables set forth, by level within the fair value hierarchy, the Company's financial assets and liabilities accounted for at fair value on a recurring basis.

(dollars in millions)	July 2, 2016			January 2, 2016			July 4, 2015		
	Level	Level	Level	Level	Level	Level	Level	Level	
	1	2	3	1	2	3	1	2	3
Assets									
Investments	\$10.9	\$—	\$—	\$8.6	\$—	\$—	\$7.9	\$—	\$—
Foreign exchange forward contracts (1)	\$—	\$—	\$—	\$—	\$2.1	\$—	\$—	\$1.6	\$—
Liabilities									
Foreign exchange forward contracts (2)	\$—	\$1.3	\$—	\$—	\$—	\$—	\$—	\$—	\$—
Contingent consideration	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$—	\$9.0

(1) Included in Prepaid expenses and other current assets in the Company's condensed consolidated balance sheet.

(2) Included in Other current liabilities in the Company's condensed consolidated balance sheet.

INVESTMENTS

The Company invests in marketable securities, principally equity-based mutual funds, to mitigate the risk associated with the investment return on employee deferrals of compensation.

Gains on the investments in marketable securities were \$0.7 million and \$0.3 million for the fiscal quarter and two fiscal quarters ended July 2, 2016, respectively. Gains on the investments in marketable securities were not material for the fiscal quarter ended July 4, 2015 and were \$0.3 million for the two fiscal quarters ended July 4, 2015. These amounts are included in Other expense (income), net on the Company's consolidated statement of operations included in this Quarterly Report on Form 10-Q.

FOREIGN EXCHANGE FORWARD CONTRACTS

Fair values for unsettled foreign exchange forward contracts are calculated by using readily observable market inputs (market-quoted currency exchange rates in effect between U.S. and Canadian dollars).

At July 2, 2016, the notional value of the open foreign currency forward contracts was approximately \$20.0 million. These contracts were marked-to-market, or to fair value, resulting in an unrealized loss of approximately \$1.3 million at July 2, 2016.

The Company recorded realized losses of approximately \$1.1 million and \$0.3 million for foreign currency forward contracts settled during the fiscal quarter and two fiscal quarters ended July 2, 2016, respectively. The Company recorded realized gains of approximately \$0.3 million for foreign currency forward contracts settled during the second quarter of fiscal 2015. These amounts are included in Other expense (income), net on the Company's consolidated statement of operations. The Company did not apply hedge accounting treatment on any of these foreign currency forward contracts.

During the first quarter of fiscal 2015, the Company had no foreign exchange forward contracts.

CONTINGENT CONSIDERATION

The following table summarizes the changes in the contingent consideration liability during the fiscal quarter and first two fiscal quarters of 2015 related to the Company's 2011 acquisition of Bonnie Togs in Canada:

12

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Fiscal quarter ended	Two fiscal quarters ended
(dollars in thousands)	July 4, 2015	July 4, 2015
Balance at the beginning of period	\$7,661	\$7,711
Accretion	326	809
Foreign currency translation adjustment	(42)	(575)
Final contingent adjustment	1,077	1,077
Balance at the end of period	\$9,022	\$9,022

At July 2, 2016 and January 2, 2016, the Company had no remaining contingent consideration liability related to the 2011 acquisition of Bonnie Togs in Canada.

BORROWINGS

As of July 2, 2016, the fair value of the Company's \$185.7 million in outstanding borrowings under its secured revolving credit facility approximated carrying value.

The fair value of the Company's senior notes at July 2, 2016 was approximately \$414 million. The fair value of these senior notes with a notional value and carrying value of \$400 million was estimated using a quoted price as provided in the secondary market, which considers the Company's credit risk and market related conditions, and is therefore within Level 2 of the fair value hierarchy.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11 – EARNINGS PER SHARE

The following is a reconciliation of basic common shares outstanding to diluted common and common equivalent shares outstanding:

	Fiscal quarter ended		Two fiscal quarters ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Weighted-average number of common and common equivalent shares outstanding:				
Basic number of common shares outstanding	50,143,568	52,020,386	50,660,278	52,069,800
Dilutive effect of equity awards	469,114	526,016	468,632	514,121
Diluted number of common and common equivalent shares outstanding	50,612,682	52,546,402	51,128,910	52,583,921
Basic net income per common share (in thousands, except per share data):				
Net income	\$36,198	\$36,105	\$90,178	\$85,897
Income allocated to participating securities	(279)	(305)	(720)	(847)
Net income available to common shareholders	\$35,919	\$35,800	\$89,458	\$85,050
Basic net income per common share	\$0.72	\$0.69	\$1.77	\$1.63
Diluted net income per common share (in thousands, except per share data):				
Net income	\$36,198	\$36,105	\$90,178	\$85,897
Income allocated to participating securities	(278)	(303)	(715)	(840)
Net income available to common shareholders	\$35,920	\$35,802	\$89,463	\$85,057
Diluted net income per common share	\$0.71	\$0.68	\$1.75	\$1.62
Anti-dilutive shares excluded from dilutive earnings per share computation	233,570	178,800	233,570	183,300

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – OTHER CURRENT AND LONG-TERM LIABILITIES

Other current liabilities that exceeded five percent of total current liabilities, at the end of any comparable period, were as follows:

(dollars in thousands)	July 2, 2016	January 2, 2016	July 4, 2015
Accrued bonuses and incentive compensation	\$6,694	\$ 17,934	\$7,400
Accrued employee benefits	8,718	19,751	8,253
Accrued and deferred rent	13,930	12,590	13,160

Other long-term liabilities that exceeded five percent of total liabilities, at the end of any comparable period, were as follows:

(dollars in thousands)	July 2, 2016	January 2, 2016	July 4, 2015
Deferred lease incentives	\$71,884	\$ 70,060	\$69,804

NOTE 13 – COMMITMENTS AND CONTINGENCIES

The Company is subject to various claims and pending or threatened lawsuits in the normal course of business. The Company is not currently a party to any legal proceedings that it believes would have a material adverse impact on its financial position, results of operations, or cash flows.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 – SEGMENT INFORMATION

The table below presents certain information for our reportable segments and unallocated corporate expenses for the periods indicated:

(dollars in thousands)	Fiscal quarter ended				Two fiscal quarters ended			
	July 2, 2016	% of Total Net Sales	July 4, 2015	% of Total Net Sales	July 2, 2016	% of Total Net Sales	July 4, 2015	% of Total Net Sales
Net sales:								
Carter's Wholesale	\$205,738	32.2 %	\$211,730	34.6 %	\$485,878	35.5 %	\$481,045	37.1 %
Carter's Retail (a)	273,832	42.8 %	246,980	40.4 %	546,155	40.1 %	504,707	39.0 %
Total Carter's (U.S.)	479,570	75.0 %	458,710	75.0 %	1,032,033	75.6 %	985,752	76.1 %
OshKosh Retail (a)	78,950	12.3 %	73,453	12.0 %	160,716	11.8 %	146,495	11.3 %
OshKosh Wholesale	9,384	1.5 %	14,306	2.3 %	21,298	1.6 %	30,357	2.3 %
Total OshKosh (U.S.)	88,334	13.8 %	87,759	14.3 %	182,014	13.4 %	176,852	13.6 %
International (b)	71,567	11.2 %	66,296	10.7 %	149,509	11.0 %	134,925	10.3 %
Total net sales	\$639,471	100.0 %	\$612,765	100.0 %	\$1,363,556	100.0 %	\$1,297,529	100.0 %
Operating income (loss):								
		% of Segment Net Sales		% of Segment Net Sales		% of Segment Net Sales		% of Segment Net Sales
Carter's Wholesale	\$39,899	19.4 %	\$40,207	19.0 %	\$106,104	21.8 %	\$98,138	20.4 %
Carter's Retail (a)	38,433	14.0 %	38,331	15.5 %	79,687	14.6 %	82,824	16.4 %
Total Carter's (U.S.)	78,332	16.3 %	78,538	17.1 %	185,791	18.0 %	180,962	18.4 %
OshKosh Retail (a)	(1,481)	(1.9 %)	(1,815)	(2.5 %)	(3,266)	(2.0 %)	(2,775)	(1.9 %)
OshKosh Wholesale	1,610	17.2 %	2,249	15.7 %	3,816	17.9 %	5,228	17.2 %
Total OshKosh (U.S.)	129	0.1 %	434	0.5 %	550	0.3 %	2,453	1.4 %
International (b) (c)	9,105	12.7						