

CARTERS INC
Form 10-Q
August 09, 2007

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 JUNE 30, 2007**

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 No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes 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 August 9, 2007 |
|--|---|
| Common stock, par value \$0.01 per share | 57,894,685 |

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)

| | June 30, 2007 | December 30, 2006 |
|--|--------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 19,848 | \$ 68,545 |
| Accounts receivable, net | 104,534 | 110,615 |
| Finished goods inventories, net | 231,588 | 193,588 |
| Prepaid expenses and other current assets | 15,000 | 7,296 |
| Assets held for sale | 6,109 | |
| Deferred income taxes | 19,087 | 22,377 |
| Total current assets | 396,166 | 402,421 |
| Property, plant, and equipment, net | 72,693 | 87,940 |
| Tradenames | 310,233 | 322,233 |
| Cost in excess of fair value of net assets acquired | 136,570 | 279,756 |
| Deferred debt issuance costs, net | 5,320 | 5,903 |
| Licensing agreements, net | 10,767 | 12,895 |
| Leasehold interests, net | 918 | 1,151 |
| Other assets | 9,568 | 10,892 |
| Total assets | \$ 942,235 | \$ 1,123,191 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Current maturities of long-term debt | \$ 2,627 | \$ 2,627 |
| Accounts payable | 85,872 | 70,878 |
| Other current liabilities | 28,563 | 63,012 |
| Total current liabilities | 117,062 | 136,517 |
| Long-term debt | 340,653 | 342,405 |
| Deferred income taxes | 115,150 | 125,784 |
| Other long-term liabilities | 32,708 | 22,994 |
| Total liabilities | 605,573 | 627,700 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Preferred stock; par value \$.01 per share; 100,000 shares authorized; none issued or outstanding at June 30, 2007 and December 30, 2006 | | |
| Common stock, voting; par value \$.01 per share; 150,000,000 shares authorized; 58,185,355 and 58,927,280 shares issued and outstanding at June 30, 2007 and December 30, 2006, respectively | 582 | 589 |
| Additional paid-in capital | 247,587 | 275,045 |
| Accumulated other comprehensive income | 5,187 | 5,301 |
| Retained earnings | 83,306 | 214,556 |

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| | | |
|--|------------|--------------|
| Total stockholders' equity | 336,662 | 495,491 |
| Total liabilities and stockholders' equity | \$ 942,235 | \$ 1,123,191 |

See accompanying notes to the unaudited condensed consolidated financial statements

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CARTER S, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(dollars in thousands, except per share data)

(unaudited)

| | For the three-month periods ended | | For the six-month periods ended | |
|---|--------------------------------------|-----------------|------------------------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Net sales | \$ 287,775 | \$ 277,577 | \$ 607,903 | \$ 574,024 |
| Cost of goods sold | 192,357 | 180,342 | 406,105 | 368,625 |
| Gross profit | 95,418 | 97,235 | 201,798 | 205,399 |
| Selling, general, and administrative expenses | 84,635 | 82,466 | 172,881 | 165,448 |
| Intangible asset impairment (Note 3) | 154,886 | | 154,886 | |
| Closure costs | 470 | 10 | 4,977 | 91 |
| Royalty income | (6,700) | (6,654) | (14,245) | (13,828) |
| Operating (loss) income | (137,873) | 21,413 | (116,701) | 53,688 |
| Interest expense, net | 5,704 | 6,929 | 11,432 | 13,813 |
| (Loss) income before income taxes | (143,577) | 14,484 | (128,133) | 39,875 |
| (Benefit from) provision for income taxes | (128) | 5,466 | 5,705 | 15,071 |
| Net (loss) income | \$ (143,449) | \$ 9,018 | \$ (133,838) | \$ 24,804 |
| Basic net (loss) income per common share | \$ (2.48) | \$ 0.16 | \$ (2.30) | \$ 0.43 |
| Diluted net (loss) income per common share | \$ (2.48) | \$ 0.15 | \$ (2.30) | \$ 0.41 |
| Basic weighted-average number of shares outstanding | 57,838,075 | 57,877,753 | 58,142,782 | 57,793,393 |
| Diluted weighted-average number of shares outstanding | 57,838,075 | 61,183,491 | 58,142,782 | 61,160,185 |

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

| | For the six-month periods ended | |
|--|------------------------------------|-----------------|
| | June 30, 2007 | July 1, 2006 |
| Cash flows from operating activities: | | |
| Net (loss) income | \$ (133,838) | \$ 24,804 |
| Adjustments to reconcile net (loss) income to net cash used in operating activities: | | |
| Depreciation and amortization | 16,282 | 12,735 |
| Amortization of debt issuance costs | 583 | 1,139 |
| Non-cash intangible asset impairment charges | 154,886 | |
| Non-cash stock-based compensation expense | 3,057 | 2,858 |
| Income tax benefit from exercised stock options | (7,038) | (2,378) |
| Loss on sale of property, plant, and equipment | 386 | 108 |
| Deferred income taxes | (7,280) | 7,236 |
| Non-cash closure costs | 2,450 | |
| Effect of changes in operating assets and liabilities: | | |
| Accounts receivable | 6,081 | (7,007) |
| Inventories | (38,000) | (2,070) |
| Prepaid expenses and other assets | (6,565) | (1,823) |
| Accounts payable and other liabilities | 686 | (38,311) |
| Net cash used in operating activities | (8,310) | (2,709) |
| Cash flows from investing activities: | | |
| Capital expenditures | (7,667) | (7,541) |
| Proceeds from sale of property, plant, and equipment | 53 | 344 |
| Net cash used in investing activities | (7,614) | (7,197) |
| Cash flows from financing activities: | | |
| Payments on term loan | (1,752) | (36,138) |
| Share repurchase | (40,012) | |
| Income tax benefit from exercised stock options | 7,038 | 2,378 |
| Proceeds from exercise of stock options | 1,953 | 1,014 |
| Net cash used in financing activities | (32,773) | (32,746) |
| Net decrease in cash and cash equivalents | (48,697) | (42,652) |
| Cash and cash equivalents, beginning of period | 68,545 | 84,276 |
| Cash and cash equivalents, end of period | \$ 19,848 | \$ 41,624 |

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 income (loss) | Retained earnings | Total stockholders equity |
|---|-----------------|----------------------------------|---|----------------------|---------------------------------|
| Balance at December 30, 2006 | \$ 589 | \$ 275,045 | \$ 5,301 | \$ 214,556 | \$ 495,491 |
| Income tax benefit from exercised stock options | | 7,267 | | | 7,267 |
| Exercise of stock options (820,624 shares) | 8 | 1,945 | | | 1,953 |
| Stock-based compensation expense | | 2,787 | | | 2,787 |
| Issuance of common stock (21,420 shares) | 1 | 539 | | | 540 |
| FIN 48 cumulative effect of adoption (Note 4) | | | | 2,588 | 2,588 |
| Share repurchase (1,647,419 shares) | (16) | (39,996) | | | (40,012) |
| Comprehensive loss: | | | | | |
| Net loss | | | | (133,838) | (133,838) |
| Settlement of pension asset, net of tax benefit of \$75 | | | (132) | | (132) |
| Unrealized loss on interest rate swap, net of tax benefit of \$22 | | | (40) | | (40) |
| Unrealized gain on interest rate collar, net of tax of \$33 | | | 58 | | 58 |
| Total comprehensive loss | | | (114) | (133,838) | (133,952) |
| Balance at June 30, 2007 | \$ 582 | \$ 247,587 | \$ 5,187 | \$ 83,306 | \$ 336,662 |

See accompanying notes to the unaudited condensed consolidated financial statements

CARTER S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 THE COMPANY:

Carter s, Inc. and its wholly owned subsidiaries (collectively, the Company, we, us, its, and our) design, source, and market branded childrenswear under the *Carter s*, *Child of Mine*, *Just One Year*, *OshKosh*, and related brands. Our products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic retailers, including the mass channel, and to our Carter s and OshKosh retail stores that market our brand name merchandise and other licensed products manufactured by other companies.

NOTE 2 BASIS OF PREPARATION:

The accompanying unaudited condensed consolidated financial statements comprise the consolidated financial statements of Carter s, Inc. and its 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 June 30, 2007, the results of our operations for the three and six-month periods ended June 30, 2007 and July 1, 2006, cash flows for the six-month periods ended June 30, 2007 and July 1, 2006 and changes in stockholders equity for the six-month period ended June 30, 2007. Operating results for the three and six-month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending December 29, 2007. Our accompanying condensed consolidated balance sheet as of December 30, 2006 is from our audited consolidated financial statements included in our most recently filed Annual Report on Form 10-K, but does not include all disclosures required by accounting principles generally accepted in the United States of America (GAAP).

Certain information and footnote disclosure normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission 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 30, 2006.

Our fiscal year ends on the Saturday in December or January nearest to the last day of December. The accompanying unaudited condensed consolidated financial statements for the second quarter and first half of fiscal 2007 reflect our financial position as of June 30, 2007. The second quarter and first half of fiscal 2006 ended on July 1, 2006.

Certain prior year amounts have been reclassified for comparative purposes.

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NOTE 3 COST IN EXCESS OF FAIR VALUE OF NET ASSETS ACQUIRED AND OTHER INTANGIBLE**ASSETS:**

In connection with the acquisition of OshKosh B'Gosh, Inc. on July 14, 2005 (the Acquisition), the Company recorded the cost in excess of fair value of net assets acquired and other intangible assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations.

As a result of the continued negative trends in sales and profitability of the Company's OshKosh B'Gosh wholesale and retail segments and the re-forecasted projections for such segments for the balance of fiscal 2007, the Company conducted an interim impairment assessment on the value of the intangible assets that the Company recorded in connection with the Acquisition. This assessment was performed in accordance with SFAS No. 142, Goodwill and Intangible Assets. Based on this assessment, charges of approximately \$36.0 million and \$106.9 million were recorded for the impairment of the cost in excess of fair value of net assets acquired for the wholesale and retail segments, respectively. In addition, an impairment charge of \$12.0 million was recorded to reflect the impairment of the value ascribed to the *OshKosh* tradename. For cost in excess of fair value of net assets acquired, the fair value was determined using the expected present value of future cash flows. For the *OshKosh* tradename, the fair value was determined using a discounted cash flow analysis which examined the hypothetical cost savings that accrue as a result of our ownership of the tradename.

As of June 30, 2007, the remaining intangible assets resulting from the Acquisition were as follows:

| (dollars in thousands) | Weighted- average useful life | Gross amount | Accumulated amortization |
|------------------------------|--|-----------------|-----------------------------|
| <i>OshKosh</i> tradename | Indefinite | \$ 90,000 | \$ |
| OshKosh licensing agreements | 4.7 years | \$ 19,100 | \$ 8,333 |
| Leasehold interests | 4.1 years | \$ 1,833 | \$ 915 |

Amortization expense for intangible assets was approximately \$1.2 million and \$2.4 million for each of the three and six-month periods ended June 30, 2007 and July 1, 2006. Annual amortization expense for the OshKosh licensing agreements and leasehold interests is expected to be as follows:

| (dollars in thousands) Fiscal Year | Estimated amortization expense |
|---|--------------------------------------|
| 2007 (period from July 1 through December 29) | \$ 2,085 |
| 2008 | 4,106 |
| 2009 | 3,717 |
| 2010 | 1,777 |
| Total | \$ 11,685 |

As described in Note 2 Summary of Significant Accounting Policies to our audited consolidated financial statements included in our most recently filed Annual Report on Form 10-K, our *Carter's* tradename and cost in excess of fair value of net assets acquired have been deemed to have indefinite lives and are not being amortized.

NOTE 4 INCOME TAXES:

Effective December 31, 2006, we adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 states that a tax benefit from an uncertain position may be recognized only if it is more likely than not that the position is sustainable, based on its technical merits. The tax benefit of a qualifying position is the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information.

In connection with the adoption of FIN 48, we recorded a cumulative effect of adoption, reducing our reserves for unrecognized tax benefits by approximately \$2.6 million as of December 31, 2006 and increasing retained earnings by \$2.6 million. Additionally, we reclassified, as of December 31, 2006, approximately \$6.9 million of reserves for unrecognized tax benefits from current liabilities to long-term liabilities on the accompanying unaudited condensed consolidated balance sheet.

The Company and its subsidiaries file income tax returns in the U.S. and in various states and local jurisdictions. The Internal Revenue Service has recently completed an income tax examination for fiscal 2003 and has recently commenced an examination of the Company's U.S. income tax returns for fiscal 2004 and fiscal 2005. In most cases, the Company is no longer subject to state and local tax authority examinations for years prior to fiscal 2003.

As of December 31, 2006, the Company had gross unrecognized tax benefits of approximately \$8.1 million, excluding interest and penalties of approximately \$1.5 million. The amount of net unrecognized tax benefits that could result in an adjustment to our effective tax rate in future periods, if recognized, was approximately \$3.1 million as of December 31, 2006.

Included in the reserves for unrecognized tax benefits are approximately \$0.8 million of reserves for which the statute of limitations expires in September 2007. Such exposures relate primarily to the deductibility of certain operating expenses from various jurisdictions. If these tax benefits are ultimately recognized, such recognition is not expected to result in a material impact on our effective tax rate for fiscal 2007, although the effective tax rate for the third quarter of fiscal 2007 may be reduced from 37.8% to 36.5%. In addition, our unrecognized tax benefits include approximately \$0.6 million of pre-Acquisition reserves for which the statute of limitations expires in September 2007. Recognition of these uncertainties would be reflected as an adjustment to the *OshKosh* tradename asset in accordance with Emerging Issues Task Force (EITF) No. 93-7, Uncertainties Related to Income Taxes in a Purchase Business Combination.

We recognize interest related to unrecognized tax benefits as a component of interest expense and penalties related to unrecognized tax benefits as a component of income tax expense. The Company had approximately \$1.8 million of interest and penalties accrued as of June 30, 2007.

The Company's effective tax rate for the second quarter and first half of fiscal 2007 was directly impacted by the impairment charges discussed in Note 3. An impairment of the cost in excess of fair value of net assets acquired does not impact the Company's taxable income as the cost in excess of fair value of net assets acquired is not deductible for tax purposes.

NOTE 5 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. Additionally, we have an obligation under a defined benefit plan covering certain former officers and their spouses. See Note 8

Employee Benefit Plans to our audited consolidated financial statements included in our most recently filed Annual Report on Form 10-K for further information.

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

| (dollars in thousands) | For the three-month periods ended | | For the six-month periods ended | |
|---|--------------------------------------|-----------------|------------------------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Service cost - benefits attributed to service during the period | \$ 28 | \$ 42 | \$ 56 | \$ 84 |
| Interest cost on accumulated post-retirement benefit obligation | 137 | 159 | 274 | 317 |
| Amortization of prior service cost | (9) | 23 | (18) | 46 |
| Total net periodic benefit cost | \$ 156 | \$ 224 | \$ 312 | \$ 447 |

The components of pension expense charged to operations are as follows:

| (dollars in thousands) | For the three-month periods ended | | For the six-month periods ended | |
|---|--------------------------------------|-----------------|------------------------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Interest cost on accumulated pension benefit obligation | \$ 15 | \$ 19 | \$ 30 | \$ 38 |

The Company acquired two defined benefit pension plans in connection with the Acquisition. The benefits for certain current and former employees of OshKosh under these pension plans were frozen as of December 31, 2005.

The Company recently received a determination letter from the Internal Revenue Service granting permission to terminate one of the acquired OshKosh pension plans, the OshKosh B-Gosh Collective Bargaining Pension Plan (the "Plan"). During the second quarter of fiscal 2007, the Company liquidated the Plan, distributed each participant's balance, and the remaining net assets of \$2.2 million were contributed to the Company's defined contribution plan to offset future employer contributions. In connection with the liquidation of the Plan, the Company recorded a pre-tax gain of approximately \$0.3 million related to the Plan settlement.

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The Company's net periodic pension benefit cost related to these plans is comprised of the following components:

| (dollars in thousands) | For the three-month periods ended | | For the six-month periods ended | |
|---|--------------------------------------|------------------|------------------------------------|------------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Interest cost on accumulated pension benefit obligation | \$ 552 | \$ 651 | \$ 1,103 | \$ 1,301 |
| Expected return on assets | (1,404) | (1,034) | (2,316) | (2,069) |
| Amortization of actuarial gain | (35) | () | (70) | () |
| Gain on settlement | (276) | () | (276) | () |
| Total net periodic benefit cost | \$ (1,163) | \$ (383) | \$ (1,559) | \$ (768) |

NOTE 6 COMMON STOCK:

On May 12, 2006, the Company amended its certificate of incorporation to increase the number of authorized shares of its common stock from 40,000,000 to 150,000,000.

On June 6, 2006, the Company effected a two-for-one stock split (the "stock split") through a stock dividend to stockholders of record as of May 23, 2006 of one share of our common stock for each share of common stock outstanding. Earnings per share for all prior periods presented have been adjusted to reflect the stock split.

On February 16, 2007, the Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to \$100 million of its outstanding common shares. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by management, based on its evaluation of market conditions, share price, and other factors.

During the second quarter and first half of fiscal 2007, the Company repurchased and retired approximately \$10 million and \$40 million, or 394,587 and 1,647,419 shares, of its common stock at an average price of \$25.37 and \$24.29 per share, respectively. Accordingly, we have reduced common stock by the par value of such shares and have deducted the remaining excess repurchase price over par value from additional paid-in capital.

During the second quarter and first half of fiscal 2007, the Company issued 21,420 shares of common stock to its non-management board members.

NOTE 7 STOCK-BASED COMPENSATION:

We account for stock-based compensation expense in accordance with SFAS No. 123 (revised 2004), Share-Based Payment. The fair value of time- or performance-based stock option grants are estimated on the date of grant using the Black-Scholes option pricing method with the following weighted-average assumptions used for grants issued during the six-month period ended June 30, 2007.

| | For the six-month period ended June 30, 2007 |
|-------------------------|---|
| Volatility | 38.16% |
| Risk-free interest rate | 4.74% |
| Expected term (years) | 6.0 |
| Dividend yield | |

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

The following table summarizes our stock option and restricted stock activity during the six-month period ended June 30, 2007:

| | Time-based stock options | Performance- based stock options | Retained stock options | Restricted stock |
|---------------------------------------|-------------------------------------|---|-----------------------------------|-----------------------------|
| Outstanding, December 30, 2006 | 4,666,678 | 620,000 | 1,071,870 | 222,620 |
| Granted | 183,200 | | | 82,800 |
| Exercised | (410,624) | | (410,000) | |
| Vested restricted stock | | | | (24,900) |
| Forfeited | (124,150) | | | (19,350) |
| Expired | | | | |
| Outstanding, June 30, 2007 | 4,315,104 | 620,000 | 661,870 | 261,170 |
| Exercisable, June 30, 2007 | 3,472,524 | | 661,870 | |

During the three-month period ended June 30, 2007, we granted 51,600 time-based stock options with a weighted-average Black-Scholes fair value of \$11.91 and a weighted-average exercise price of \$26.57. In connection with these grants, we recognized approximately \$11,800 in stock-based compensation expense during the three-month period ended June 30, 2007.

During the six-month period ended June 30, 2007, we granted 183,200 time-based stock options with a weighted-average Black-Scholes fair value of \$10.55 and a weighted-average exercise price of \$23.42. In connection with these grants, we recognized approximately \$123,000 in stock-based compensation expense during the six-month period ended June 30, 2007.

During the three-month period ended June 30, 2007, we granted 15,400 shares of restricted stock to employees with a weighted-average fair value on the date of grant of \$26.30. In connection with these grants, we recognized approximately \$8,400 in stock-based compensation expense during the three-month period ended June 30, 2007.

During the six-month period ended June 30, 2007, we granted 82,800 shares of restricted stock to employees with a weighted-average fair value on the date of grant of \$22.95. In connection with these grants, we recognized approximately \$132,000 in stock-based compensation expense during the six-month period ended June 30, 2007.

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

| (dollars in thousands) | Time- based stock options | Performance- based stock options | Restricted stock | Total |
|---|------------------------------------|---|---------------------|-----------|
| 2007 (period from July 1 through December 29) | \$ 1,320 | \$ 753 | \$ 910 | \$ 2,983 |
| 2008 | 2,561 | 1,519 | 1,831 | 5,911 |
| 2009 | 1,541 | 721 | 1,361 | 3,623 |
| 2010 | 574 | 84 | 573 | 1,231 |
| 2011 | 94 | | 77 | 171 |
| Total | \$ 6,090 | \$ 3,077 | \$ 4,752 | \$ 13,919 |

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NOTE 8 SEGMENT INFORMATION:

We report segment information in accordance with the provisions of SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, 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.

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

| (dollars in thousands) | For the three-month periods ended | | July 1, 2006 | % of Total | For the six-month periods ended | | July 1, 2006 | % of Total |
|------------------------|-----------------------------------|------------|--------------|------------|---------------------------------|------------|--------------|------------|
| | June 30, 2007 | % of Total | | | June 30, 2007 | % of Total | | |
| Net sales: | | | | | | | | |
| Wholesale-Carter s | \$ 93,294 | 32.4 % | \$ 84,095 | 30.3 % | \$ 205,947 | 33.9 % | \$ 186,456 | 32.5 % |
| Wholesale-OshKosh | 10,227 | 3.6 % | 20,411 | 7.3 % | 35,220 | 5.8 % | 49,092 | 8.5 % |
| Retail-Carter s | 76,275 | 26.5 % | 71,395 | 25.7 % | 151,101 | 24.8 % | 140,463 | 24.5 % |
| Retail-OshKosh | 48,885 | 17.0 % | 50,703 | 18.3 % | 94,733 | 15.6 % | 93,015 | 16.2 % |
| Mass Channel-Carter s | 59,094 | 20.5 % | 50,973 | 18.4 % | 120,902 | 19.9 % | 104,998 | 18.3 % |
| Total net sales | \$ 287,775 | 100.0 % | \$ 277,577 | 100.0 % | \$ 607,903 | 100.0 % | \$ 574,024 | 100.0 % |

| | | % of segment net sales | | % of segment net sales | | % of segment net sales | | % of segment net sales |
|---------------------------------|---------------|------------------------|-----------|------------------------|---------------|------------------------|-----------|------------------------|
| Operating (loss) income: | | | | | | | | |
| Wholesale-Carter s | \$ 16,102 | 17.3 % | \$ 12,298 | 14.6 % | \$ 37,488 | 18.2 % | \$ 32,736 | 17.6 % |
| Wholesale-OshKosh (a) | (38,942) | (380.8) % | 1,231 | 6.0 % | (39,629) | (112.5) % | 4,584 | 9.3 % |
| Retail-Carter s | 5,727 | 7.5 % | 8,691 | 12.2 % | 13,636 | 9.0 % | 19,951 | 14.2 % |
| Retail-OshKosh (b) | (108,617) | (222.2) % | 2,602 | 5.1 % | (109,910) | (116.0) % | 2,832 | 3.0 % |
| Mass Channel-Carter s | 8,794 | 14.9 % | 6,801 | 13.3 % | 17,145 | 14.2 % | 14,978 | 14.3 % |
| Mass Channel-OshKosh (c) | 361 | | 706 | | 888 | | 836 | |
| Segment operating (loss) income | (116,575) | (40.5) % | 32,329 | 11.6 % | (80,382) | (13.2) % | 75,917 | 13.2 % |
| Other reconciling items (d) | (21,298) | (7.4) % | (10,916) | (3.9) % | (36,319) | (6.0) % | (22,229) | (3.9) % |
| Total operating (loss) income | \$ (137,873) | (47.9) % | \$ 21,413 | 7.7 % | \$ (116,701) | (19.2) % | \$ 53,688 | 9.4 % |

(a) OshKosh wholesale includes a charge of approximately \$36.0 million related to the impairment of the OshKosh cost in excess of fair value of net assets acquired related to the wholesale segment.

(b) OshKosh retail includes a charge of approximately \$106.9 million related to the impairment of the OshKosh cost in excess of fair value of net assets acquired related to the retail segment.

(c) OshKosh mass channel consists of a licensing agreement with Target Stores. Operating income consists of royalty income, net of related expenses.

(d) Other reconciling items include a charge of \$12.0 million related to the impairment of the *OshKosh* tradename.

The following represents cost in excess of fair value of net assets acquired by segment:

| (dollars in thousands) | Wholesale Carter s | Wholesale OshKosh | Retail Carter s | Retail OshKosh | Mass Channel Carter s | Total |
|-------------------------------------|--------------------|-------------------|-----------------|----------------|-----------------------|------------|
| Balance at December 30, 2006 | \$ 51,814 | \$ 36,071 | \$ 82,025 | \$ 107,115 | \$ 2,731 | \$ 279,756 |
| Intangible asset impairment | | (35,995) | | (106,891) | | (142,886) |
| Adjustments | | (76) | | (224) | | (300) |

NOTE 4 INCOME TAXES:

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| | | | | | | | | | | | | |
|---------------------------------|----|--------|----|--|----|--------|----|--|----|-------|----|---------|
| Balance at June 30, 2007 | \$ | 51,814 | \$ | | \$ | 82,025 | \$ | | \$ | 2,731 | \$ | 136,570 |
|---------------------------------|----|--------|----|--|----|--------|----|--|----|-------|----|---------|

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NOTE 9 FACILITY CLOSURE AND RESTRUCTURING COSTS:***White House Distribution Facility***

The Company continually evaluates opportunities to reduce its supply chain complexity and lower costs. In the first quarter of fiscal 2007, the Company determined that *OshKosh* brand products could be effectively distributed through its other distribution facilities and third-party logistics providers. On February 15, 2007, the Company's Board of Directors approved management's plan to close the Company's White House, Tennessee distribution facility, which was utilized to distribute the Company's *OshKosh* brand products.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, under a held and used model, it was determined that the distribution facility assets were impaired as of the end of January 2007, as it became more likely than not that the expected life of the White House distribution facility would be significantly shortened. Accordingly, we have written down the assets to their estimated recoverable fair value as of the end of January 2007. The adjusted asset values were subject to accelerated depreciation over their remaining estimated useful life. Distribution operations at the White House facility ceased as of April 5, 2007, at which point the White House land, building, and equipment assets of \$6.1 million were reclassified as held for sale on the accompanying unaudited condensed consolidated balance sheet.

For a majority of the affected employees, severance benefits were communicated on February 20, 2007. Approximately 215 employees were terminated. In connection with this closure, we expect to incur approximately \$3.9 million in cash expenses. These cash expenses consist of severance and other costs to exit the facility. The Company also incurred approximately \$4.6 million of non-cash charges relating to accelerated depreciation and asset impairment.

During the first half of fiscal 2007, we recorded costs of \$7.1 million, consisting of asset impairment charges of \$2.4 million related to a write-down of the related land, building, and equipment, \$2.0 million of severance charges, \$2.1 million of accelerated depreciation (included in selling, general, and administrative expenses), and \$0.6 million of other closure costs.

The following table summarizes restructuring reserves related to the closure of the White House facility which are included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet:

| (dollars in thousands) | Severance | Other exit costs | Total |
|----------------------------------|-----------|------------------------|----------|
| Balance at March 31, 2007 | \$ 2,040 | \$ 45 | \$ 2,085 |
| Provisions | | 470 | 470 |
| Payments | (1,234) | (515) | (1,749) |
| Balance at June 30, 2007 | \$ 806 | \$ | \$ 806 |

Acquisition Restructuring

In connection with the Acquisition, management developed a plan to restructure and integrate the operations of OshKosh. In accordance with EITF No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, liabilities were established for OshKosh severance, lease termination costs associated with the closure of OshKosh's 15 Lifestyle stores and 14 outlet stores in fiscal 2005, one outlet store closure in fiscal 2006, contract termination costs, and other exit costs. These liabilities also covered costs related to the closure of OshKosh's Choloma, Honduras sewing facility, the Uman, Mexico sewing facility, and the Liberty, Kentucky distribution center. The Honduras and Kentucky facilities were closed during the fourth quarter of fiscal 2005. The Mexico facility was closed during the first quarter of fiscal 2006 and all remaining liabilities have been paid.

The following table summarizes restructuring reserves related to the Acquisition which are included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet:

| (dollars in thousands) | Severance | Other exit costs | Lease termination costs | Contract termination costs | Total |
|---|-----------|------------------------|-------------------------------|----------------------------------|----------|
| Balance at December 30, 2006 | \$ 2,135 | \$ 719 | \$ 1,733 | \$ 200 | \$ 4,787 |
| Payments | (626) | (473) | (610) | | (1,709) |
| Balance at March 31, 2007 | 1,509 | 246 | 1,123 | 200 | 3,078 |
| Payments | (288) | (154) | (469) | | (911) |
| Adjustments to cost in excess of fair value of net assets acquired | (100) | | | (200) | (300) |
| Balance at June 30, 2007 | \$ 1,121 | \$ 92 | \$ 654 | \$ | \$ 1,867 |

Sewing Facility Closures

In May 2005, we decided to exit two *Carter's* brand sewing facilities in Mexico. During the first half of fiscal 2006, we recorded total charges of \$91,000, including \$74,000 in severance charges and \$17,000 in other exit costs related to these closures.

NOTE 10 EARNINGS PER SHARE:

In accordance with SFAS No. 128, Earnings Per Share, basic earnings per share is based on the weighted-average number of common shares outstanding during the year, whereas diluted earnings per share also gives effect to all potentially dilutive shares of common stock, including time-based and retained stock options and unvested restricted stock, that were outstanding during the period. All such stock options are reflected in the denominator using the treasury stock method. This method assumes that shares are issued for stock options that are in the money, but that we use the proceeds of such stock option exercises (generally, cash to be paid plus future compensation expense to be recognized and the amount of tax benefits, if any, that will be credited to additional paid-in capital assuming exercise of the stock options) to repurchase shares at the average market value of our shares for the respective periods. Unvested shares of restricted stock are reflected in the denominator using the treasury stock method with proceeds of the amount, if any, the employees must pay upon vesting, the amount of compensation cost attributed to future services and not yet recognized in earnings, and the amount of tax benefits, if any, that would be credited to additional paid-in capital (i.e., the amount of the tax deduction in excess of recognized compensation cost) assuming vesting of the shares at the current market price.

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For the three and six-month periods ended June 30, 2007, diluted net loss per common share is the same as basic net loss per common share, as the effects of the Company's potential common stock equivalents are anti-dilutive. For the three and six-month periods ended July 1, 2006, anti-dilutive shares of 370,400 and performance-based stock options of 600,000, were excluded from the computations of diluted earnings per share.

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

| (dollars in thousands, except per share data) | For the three-month periods ended | | For the six-month periods ended | |
|---|--------------------------------------|-----------------|------------------------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Net (loss) income | \$ (143,449) | \$ 9,018 | \$ (133,838) | \$ 24,804 |
| Weighted-average number of common and common equivalent shares outstanding: | | | | |
| Basic number of common shares outstanding | 57,838,075 | 57,877,753 | 58,142,782 | 57,793,393 |
| Dilutive effect of unvested restricted stock | | 42,322 | | 38,786 |
| Dilutive effect of stock options | | 3,263,416 | | 3,328,006 |
| Diluted number of common and common equivalent shares outstanding | 57,838,075 | 61,183,491 | 58,142,782 | 61,160,185 |
| Basic net (loss) income per common share | \$ (2.48) | \$ 0.16 | \$ (2.30) | \$ 0.43 |
| Diluted net (loss) income per common share | \$ (2.48) | \$ 0.15 | \$ (2.30) | \$ 0.41 |

NOTE 11 RECENT ACCOUNTING PRONOUNCEMENTS:

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of our 2008 fiscal year. We are currently evaluating the impact that SFAS 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159), which provides entities with an option to report selected financial assets and liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This statement is effective as of the beginning of the first fiscal year that begins after November 15, 2007. We are currently evaluating the impact that SFAS 159 will have on our consolidated financial statements.

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. You should read this discussion 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 to the last day of December. The accompanying unaudited condensed consolidated financial statements for the second quarter and first half of fiscal 2007 reflect our financial position as of June 30, 2007. The second quarter and first half of fiscal 2006 ended on July 1, 2006.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated (i) selected statement of operations data expressed as a percentage of net sales and (ii) the number of retail stores open at the end of each period:

| | Three-month periods ended | | Six-month periods ended | |
|---|---------------------------|-----------------|-------------------------|-----------------|
| | June 30, 2007 | July 1, 2006 | June 30, 2007 | July 1, 2006 |
| Wholesale sales: | | | | |
| Carter's | 32.4 | 30.3 | 33.9 | 32.5 |
| OshKosh | 3.6 | 7.3 | 5.8 | 8.5 |
| Total wholesale sales | 36.0 | 37.6 | 39.7 | 41.0 |
| Retail store sales: | | | | |
| Carter's | 26.5 | 25.7 | 24.8 | 24.5 |
| OshKosh | 17.0 | 18.3 | 15.6 | 16.2 |
| Total retail store sales | 43.5 | 44.0 | 40.4 | 40.7 |
| Mass channel sales | 20.5 | 18.4 | 19.9 | 18.3 |
| Consolidated net sales | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of goods sold | 66.8 | 65.0 | 66.8 | 64.2 |
| Gross profit | 33.2 | 35.0 | 33.2 | 35.8 |
| Selling, general, and administrative expenses | 29.4 | 29.7 | 28.4 | 28.8 |
| Intangible asset impairment | 53.8 | | 25.5 | |
| Closure costs | 0.2 | | 0.8 | |
| Royalty income | (2.3) | (2.4) | (2.3) | (2.4) |
| Operating (loss) income | (47.9) | 7.7 | (19.2) | 9.4 |
| Interest expense, net | 2.0 | 2.5 | 1.9 | 2.5 |
| (Loss) income before income taxes | (49.9) | 5.2 | (21.1) | 6.9 |
| (Benefit from) provision for income taxes | (0.1) | 2.0 | 0.9 | 2.6 |
| Net (loss) income | (49.8)% | 3.2% | (22.0)% | 4.3% |
| Number of retail stores at end of period: | | | | |
| Carter's | 221 | 200 | 221 | 200 |
| OshKosh | 159 | 143 | 159 | 143 |
| Total | 380 | 343 | 380 | 343 |

Three and six-month periods ended June 30, 2007 compared to the three and six-month periods ended July 1, 2006**CONSOLIDATED NET SALES**

In the second quarter of fiscal 2007, consolidated net sales increased \$10.2 million, or 3.7%, to \$287.8 million. This increase reflects sales growth in all of our *Carter* brand distribution channels, partially offset by the decrease in OshKosh wholesale and OshKosh retail sales. In the first half of fiscal 2007, consolidated net sales increased \$33.9 million, or 5.9%, to \$607.9 million. This increase reflects growth in all of our *Carter* brand distribution channels and our *OshKosh* brand retail store segment.

| (dollars in thousands) | For the three-month periods ended | | | | For the six-month periods ended | | | |
|------------------------|-----------------------------------|---------------|-----------------|---------------|---------------------------------|---------------|-----------------|---------------|
| | June 30, 2007 | % of Total | July 1, 2006 | % of Total | June 30, 2007 | % of Total | July 1, 2006 | % of Total |
| Net sales: | | | | | | | | |
| Wholesale-Carter s | \$ 93,294 | 32.4 % | \$ 84,095 | 30.3 % | \$ 205,947 | 33.9 % | \$ 186,456 | 32.5 % |
| Wholesale-OshKosh | 10,227 | 3.6 % | 20,411 | 7.3 % | 35,220 | 5.8 % | 49,092 | 8.5 % |
| Retail-Carter s | 76,275 | 26.5 % | 71,395 | 25.7 % | 151,101 | 24.8 % | 140,463 | 24.5 % |
| Retail-OshKosh | 48,885 | 17.0 % | 50,703 | 18.3 % | 94,733 | 15.6 % | 93,015 | 16.2 % |
| Mass Channel-Carter s | 59,094 | 20.5 % | 50,973 | 18.4 % | 120,902 | 19.9 % | 104,998 | 18.3 % |
| Total net sales | \$ 287,775 | 100.0 % | \$ 277,577 | 100.0 % | \$ 607,903 | 100.0 % | \$ 574,024 | 100.0 % |

CARTER S WHOLESALE SALES

Carter brand wholesale sales increased \$9.2 million, or 10.9%, in the second quarter of fiscal 2007 to \$93.3 million. Excluding off-price sales, *Carter* brand wholesale sales increased \$9.4 million, or 12.4%, to \$85.4 million in the second quarter of fiscal 2007. The increase in *Carter* brand wholesale sales, excluding off-price sales, was driven by a 9% increase in units shipped and a 3% increase in average price per unit as compared to the second quarter of fiscal 2006.

Carter brand wholesale sales increased \$19.5 million, or 10.5%, in the first half of fiscal 2007 to \$205.9 million. Excluding off-price sales, *Carter* brand wholesale sales increased \$19.7 million, or 11.4%, to \$192.4 million in the first half of fiscal 2007. The increase in *Carter* brand wholesale sales, excluding off-price sales, was driven by a 9% increase in units shipped and a 2% increase in average price per unit as compared to the first half of fiscal 2006.

The increase in units shipped during the second quarter and first half of fiscal 2007 was driven by increased units shipped in the playwear and baby product categories as a result of increased demand, partially offset by lower sleepwear units shipped. The increase in average price per unit during the second quarter and first half of fiscal 2007 was due primarily to increases in average prices in each of our product categories.

Off-price sales decreased 2.3% as compared to the second quarter of fiscal 2006 due to lower average prices, partially offset by an increase in units shipped. Off-price sales decreased 1.8% as compared to the first half of fiscal 2006 due primarily to a decrease in off-price units shipped.

OSHKOSH WHOLESALE SALES

OshKosh brand wholesale sales decreased \$10.2 million, or 49.9%, in the second quarter of fiscal 2007 to \$10.2 million. Excluding off-price sales, *OshKosh* brand wholesale sales decreased \$8.2 million, or 45.3%, to \$9.9 million in the second quarter of fiscal 2007. The decrease in *OshKosh* brand wholesale sales, excluding off-price sales, reflects primarily the timing of fall products shipped to our wholesale customers and reduced levels of demand for summer products.

OshKosh brand wholesale sales decreased \$13.9 million, or 28.3%, in the first half of fiscal 2007 to \$35.2 million. Excluding off-price sales, *OshKosh* brand wholesale sales decreased \$10.2 million, or 23.2%, to \$34.0 million in the first half of fiscal 2007. The decrease in *OshKosh* brand wholesale sales, excluding off-price sales, reflects the timing of fall products shipped to our wholesale customers and reduced levels of demand for spring and summer products.

Off-price sales decreased \$2.0 million, or 86.1%, in the second quarter of fiscal 2007 to \$0.3 million. In the first half of fiscal 2007, off-price sales decreased \$3.6 million, or 74.1%, to \$1.3 million. These decreases resulted from reduced levels of off-price inventory available for sale.

MASS CHANNEL SALES

Mass channel sales increased \$8.1 million, or 15.9%, in the second quarter of fiscal 2007 to \$59.1 million. The increase was driven by increased sales of \$5.7 million, or 17.3%, of our *Child of Mine* brand to Wal-Mart and increased sales of \$2.5 million, or 13.5%, of our *Just One Year* brand to Target. These increases in sales resulted primarily from increased productivity and new door growth.

Mass channel sales increased \$15.9 million, or 15.1%, in the first half of fiscal 2007 to \$120.9 million. The increase was driven by increased sales of \$11.1 million, or 16.8%, of our *Child of Mine* brand to Wal-Mart and increased sales of \$4.8 million, or 12.4%, of our *Just One Year* brand to Target. These increases in sales resulted primarily from increased productivity and new door growth.

CARTER S RETAIL STORES SALES

Carter s retail store sales increased \$4.9 million, or 6.8%, in the second quarter of fiscal 2007 to \$76.3 million. The increase was driven by incremental sales of \$5.3 million generated by new store openings and a comparable store sales increase of \$0.5 million, or 0.8%, partially offset by the impact of store closures of \$0.9 million.

During the second quarter of fiscal 2007, on a comparable store basis, units per transaction increased 4.7% and average prices decreased 3.3%. Average prices during the second quarter decreased primarily due to increased promotional pricing on spring playclothes. Increased promotional pricing also drove the increase in units per transaction. Average inventory levels, on a comparable store basis, were flat as compared to the second quarter of fiscal 2006.

Carter s retail store sales increased \$10.6 million, or 7.6%, in the first half of fiscal 2007 to \$151.1 million. The increase was driven by incremental sales of \$12.0 million generated by new store openings and a comparable store sales increase of \$1.0 million, or 0.7%, partially offset by the impact of store closures of \$2.3 million.

During the first half of fiscal 2007, on a comparable store basis, units per transaction increased 4.7% and average prices decreased 4.7%. Average prices decreased primarily due to increased promotional pricing on spring playclothes and baby products. Increased promotional pricing also drove the increase in units per transaction. Average inventory levels, on a comparable store basis, were down 6.1% as compared to the first half of fiscal 2006.

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 for such store will continue to be included in the comparable store calculation. If a store relocates to another center or there is a material change in square footage, such store is treated as a new store. Stores that are closed during the period are included in the comparable store sales calculation up to the date of closing.

There were a total of 221 Carter s retail stores as of June 30, 2007. During the second quarter of fiscal 2007, we opened one store. During the first half of fiscal 2007, we opened two Carter s retail stores. In total, we plan to open ten and close six Carter s retail stores during fiscal 2007.

OSHKOSH RETAIL STORES SALES

OshKosh retail store sales decreased \$1.8 million, or 3.6%, in the second quarter of fiscal 2007 to \$48.9 million. The decrease was due to a comparable store sales decrease of \$4.8 million, or 9.7%, and the impact of store closings of \$0.3 million, partially offset by incremental sales of \$3.3 million generated by new store openings. On a comparable store basis, transactions decreased 8.8%, average prices decreased 0.2%, and units per transaction were down 0.8%. Average inventory levels, on a comparable store basis, were up 8% as compared to the second quarter of fiscal 2006.

OshKosh retail store sales increased \$1.7 million, or 1.8%, in the first half of fiscal 2007 to \$94.7 million. The increase was driven by incremental sales of \$6.9 million generated by new store openings, partially offset by a comparable store sales decrease of \$4.5 million, or 4.9%, and the impact of store closings of \$0.6 million. On a comparable store basis, average prices were flat and units per transaction decreased 0.7%. Average inventory levels, on a comparable store basis, were up 3% as compared to the first half of fiscal 2006.

There were a total of 159 OshKosh retail stores as of June 30, 2007. During the second quarter and first half of fiscal 2007, we opened two stores. In total, we plan to open eight and close three OshKosh retail stores during fiscal 2007.

GROSS PROFIT

Our gross profit decreased \$1.8 million, or 1.9%, to \$95.4 million in the second quarter of fiscal 2007. Gross profit as a percentage of net sales was 33.2% in the second quarter of fiscal 2007 as compared to 35.0% in the second quarter of fiscal 2006. Our gross profit decreased \$3.6 million, or 1.8%, to \$201.8 million in the first half of fiscal 2007. Gross profit as a percentage of net sales was 33.2% in the first half of fiscal 2007 as compared to 35.8% in the first half of fiscal 2006.

These decreases in gross profit as a percentage of net sales reflects:

- (i) a decrease in gross profit in our consolidated retail segments due to product upgrades and increased promotional pricing (gross profit dollars in our consolidated retail business decreased in both periods despite an increase in consolidated retail net sales of 2.5% in the second quarter of fiscal 2007 and 5.3% in the first half of fiscal 2007);
- (ii) the impact of *OshKosh* brand wholesale spring and summer product performance, which led to higher levels of customer accommodations in the second quarter and first half of fiscal 2007; and
- (iii) a decline in gross profit from our mass channel brands in the first half of fiscal 2007 resulting from product upgrades.

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 second quarter of fiscal 2007 increased \$2.2 million, or 2.6%, to \$84.6 million. As a percentage of net sales, selling, general, and administrative expenses in the second quarter of fiscal 2007 were 29.4% as compared to 29.7% in the second quarter of fiscal 2006. Selling, general, and administrative expenses in the first half of fiscal 2007 increased \$7.4 million, or 4.5%, to \$172.9 million. As a percentage of net sales, selling, general, and administrative expenses in the first half of fiscal 2007 were 28.4% as compared to 28.8% in the first half of fiscal 2006.

These decreases in selling, general, and administrative expenses as a percentage of net sales reflects:

- (i) controlling growth in spending at a rate lower than the growth in net sales; and
- (ii) a reduction in incentive compensation expense of \$2.7 million and \$3.2 million as compared to the second quarter and first half of fiscal 2006, respectively.

Partially offsetting these decreases were:

- (i) growth in our consolidated retail store selling, general, and administrative expenses from 29.4% of consolidated retail store sales in the second quarter of fiscal 2006 to 31.0% of consolidated retail store sales in the second quarter of fiscal 2007 and from 29.6% of consolidated retail store sales in the first half of fiscal 2006 to 30.9% of consolidated retail store sales in the first half of fiscal 2007 driven primarily by the higher cost structure and lower sales volume of our brand stores; and
- (ii) accelerated depreciation charges of \$0.6 million and \$2.1 million in the second quarter and first half of fiscal 2007 related to the closure of our White House, Tennessee distribution facility.

INTANGIBLE ASSET IMPAIRMENT

As a result of the continued negative trends in sales and profitability of the Company's OshKosh B Gosh wholesale and retail segments and the re-forecasted projections for such segments for the balance of fiscal 2007, the Company conducted an interim impairment assessment on the value of the intangible assets that the Company recorded in connection with the acquisition of OshKosh B Gosh, Inc. in July 2005 (the Acquisition). This assessment was performed in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Intangible Assets. Based on this assessment, charges of approximately \$36.0 million and \$106.9 million were recorded for the impairment of the cost in excess of fair value of net assets acquired for the wholesale and retail segments, respectively. In addition, an impairment charge of \$12.0 million was recorded to reflect the impairment of the value ascribed to the *OshKosh* tradename.

CLOSURE COSTS

On February 15, 2007, the Board of Directors approved management's plan to close the Company's White House, Tennessee distribution facility, which was utilized to distribute the Company's *OshKosh* brand products. As a result of this closure, during the second quarter of fiscal 2007, we recorded costs of \$1.1 million, consisting of accelerated depreciation (included in selling, general, and administrative expenses) of \$0.6 million and \$0.5 million of other closure costs.

In the first half of fiscal 2007, we recorded costs of \$7.1 million, consisting of asset impairment charges of \$2.4 million related to a write-down of the related land, building, and equipment, \$2.0 million of severance charges, \$2.1 million of accelerated depreciation (included in selling, general, and administrative expenses), and \$0.6 million in other closure costs.

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In May 2005, we decided to exit two *Carter's* brand sewing facilities in Mexico. In the first half of fiscal 2006, in connection with these closures, we recorded costs of \$91,000, including \$74,000 of severance and \$17,000 of other exit costs.

ROYALTY INCOME

We license the use of our *Carter's*, *Just One Year*, *Child of Mine*, *OshKosh*, and *Genuine Kids from OshKosh* brand names. Royalty income from these brands was approximately \$6.7 million (including \$1.6 million and \$1.7 million of international royalty income from our *OshKosh* brands) in the second quarters of fiscal 2007 and fiscal 2006.

Royalty income from these brands was approximately \$14.2 million in the first half of fiscal 2007, an increase of 3.0%, or \$0.4 million, as compared to the first half of fiscal 2006. This increase was driven primarily by increased sales by our *OshKosh* brand domestic licensees.

OPERATING (LOSS) INCOME

Our operating loss was \$137.9 million in the second quarter of fiscal 2007 as compared to operating income of \$21.4 million in the second quarter of fiscal 2006. Our operating loss was \$116.7 million in the first half of fiscal 2007 as compared to operating income of \$53.7 million in the first half of fiscal 2006. These decreases in operating results are due to the factors described above, including the costs incurred in the second quarter and first half of fiscal 2007 related to the impairment of OshKosh's intangible assets and the closure of our White House, Tennessee distribution facility.

INTEREST EXPENSE, NET

Interest expense in the second quarter of fiscal 2007 decreased \$1.2 million, or 17.7%, to \$5.7 million. The decrease is attributable to lower average borrowings in the second quarter of fiscal 2007, due to accelerated debt reduction in fiscal 2006 and a lower effective interest rate. Weighted-average borrowings in the second quarter of fiscal 2007 were \$343.9 million at an effective interest rate of 7.13% as compared to weighted-average borrowings in the second quarter of fiscal 2006 of \$406.3 million at an effective interest rate of 7.48%. In the second quarters of fiscal 2007 and 2006, we included in interest expense approximately \$0.4 million and \$0.2 million related to our interest rate swap agreement which effectively reduced our interest expense under the term loan.

Interest expense in the first half of fiscal 2007 decreased \$2.4 million, or 17.2%, to \$11.4 million. The decrease is attributable to lower average borrowings in the first half of fiscal 2007, due to accelerated debt reduction in fiscal 2006, partially offset by a higher effective interest rate. Weighted-average borrowings in the first half of fiscal 2007 were \$344.3 million at an effective interest rate of 7.17% as compared to weighted-average borrowings in the first half of fiscal 2006 of \$416.5 million at an effective interest rate of 7.09%. In the first half of fiscal 2007 and 2006, we included in interest expense approximately \$0.9 million and \$0.4 million related to our interest rate swap agreement which effectively reduced our interest expense under the term loan.

INCOME TAXES

Our effective tax rate was 0.1% for the second quarter of fiscal 2007, 37.7% for the second quarter of fiscal 2006, 4.5% for the first half of fiscal 2007, and 37.8% for the first half of fiscal 2006. The 0.1% benefit against our pre-tax loss for the second quarter of fiscal 2007 and the 4.5% effective tax rate for the first half of fiscal 2007 is a result of the impairment of our OshKosh cost in excess of fair value of net assets acquired asset which is not deductible for income tax purposes.

NET (LOSS) INCOME

As a result of the factors above, we recorded a net loss for the second quarter of fiscal 2007 of \$143.4 million as compared to net income of \$9.0 million in the second quarter of fiscal 2006. We recorded a net loss for the first half of fiscal 2007 of \$133.8 million as compared to net income of \$24.8 million in the first half of fiscal 2006.

FINANCIAL CONDITION, CAPITAL RESOURCES, AND LIQUIDITY

Our primary cash needs are working capital, capital expenditures, and debt service. Our primary source of liquidity will continue to be cash flow from operations and borrowings under our revolver, and we expect that these sources will fund our ongoing requirements for working capital, capital expenditures, and debt service. These sources of liquidity may be impacted by continued demand for our products and our ability to meet debt covenants under our senior credit facility.

Net accounts receivable at June 30, 2007 were \$104.5 million compared to \$103.2 million at July 1, 2006 and \$110.6 million at December 30, 2006. The increase as compared to July 1, 2006 reflects higher levels of *Carter's* brand revenue in the latter part of the second quarter of fiscal 2007 as compared to the second quarter of fiscal 2006. Due to the seasonal nature of our operations, the net accounts receivable balance at June 30, 2007 is not comparable to the net accounts receivable balance at December 30, 2006.

Net inventories at June 30, 2007 were \$231.6 million compared to \$190.5 million at July 1, 2006 and \$193.6 million at December 30, 2006. The increase of \$41.1 million, or 21.6%, as compared to July 1, 2006 is due primarily to timing of receipts of playwear product inventory and increased levels of *Carter's* baby product inventory to support higher levels of demand. Due to the seasonal nature of our operations, net inventories at June 30, 2007 are not comparable to net inventories at December 30, 2006.

Net cash used in operating activities for the first half of fiscal 2007 was \$8.3 million compared to \$2.7 million in the first half of fiscal 2006. The change in net cash used in operating activities in the first half of fiscal 2007 as compared to the first half of fiscal 2006 is primarily attributable to increased levels of inventory primarily due to timing of receipts and lower levels of earnings.

On February 16, 2007, the Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to \$100 million of its outstanding common shares. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by management, based on its evaluation of market conditions, share price, and other factors.

During the second quarter and first half of fiscal 2007, the Company repurchased and retired approximately \$10 million and \$40 million, or 394,587 and 1,647,419 shares, of its common stock at an average price of \$25.37 and \$24.29 per share, respectively. Accordingly, we have reduced common stock by the par value of such shares and have deducted the remaining excess repurchase price over par value from additional paid-in capital. Subject to market conditions and availability on the revolver, the Company plans to continue to repurchase shares during the balance of fiscal 2007.

As a result of the closure of the White House, Tennessee distribution facility, we recorded costs in the first half of fiscal 2007 of \$7.1 million, consisting of asset impairment charges of \$2.4 million related to a write-down of the related land, building, and equipment, \$2.0 million of severance charges, \$2.1 million of accelerated depreciation (included in selling, general, and administrative expenses), and \$0.6 million of other closure costs. Additional cash charges to be incurred during the remainder of fiscal 2007 are estimated to be \$0.9 million of other exit costs. We expect to incur \$0.5 million of additional cash charges in fiscal 2008, consisting primarily of other exit costs. The estimated annual savings resulting from the closure of this facility is approximately \$4.0 million beginning in the second half of fiscal 2007.

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The following table summarizes restructuring reserves related to the closure of the White House facility which are included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet:

| (dollars in thousands) | Severance | Other exit costs | Total |
|----------------------------------|-----------|------------------------|----------|
| Balance at March 31, 2007 | \$ 2,040 | \$ 45 | \$ 2,085 |
| Provisions | | 470 | 470 |
| Payments | (1,234) | (515) | (1,749) |
| Balance at June 30, 2007 | \$ 806 | \$ | \$ 806 |

The estimated value of the White House assets as of June 30, 2007 is \$6.1 million. These assets are classified as held for sale on the accompanying unaudited condensed consolidated balance sheet.

In connection with the Acquisition, management developed an integration plan that includes severance, certain facility and store closings, and contract termination costs. The following liabilities, included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet, were established at the closing of the Acquisition, will be funded by cash flows from operations and borrowings under our revolver, and are expected to be paid in fiscal 2007 and fiscal 2008:

| (dollars in thousands) | Severance | Other exit costs | Lease termination costs | Contract termination costs | Total |
|---|-----------|------------------------|-------------------------------|----------------------------------|----------|
| Balance at December 30, 2006 | \$ 2,135 | \$ 719 | \$ 1,733 | \$ 200 | \$ 4,787 |
| Payments | (626) | (473) | (610) | | (1,709) |
| Balance at March 31, 2007 | 1,509 | 246 | 1,123 | 200 | 3,078 |
| Payments | (288) | (154) | (469) | | (911) |
| Adjustments to cost in excess of fair value of net assets acquired | (100) | | | (200) | (300) |
| Balance at June 30, 2007 | \$ 1,121 | \$ 92 | \$ 654 | \$ | \$ 1,867 |

We invested approximately \$7.7 million in capital expenditures during the first half of fiscal 2007 compared to approximately \$7.5 million during the first half of fiscal 2006. We plan to invest an additional \$24 million to \$27 million in capital expenditures during the remainder of fiscal 2007. Major investments include retail store openings and remodelings, investments in information technology, and fixturing programs for wholesale customers.

Weighted-average borrowings for the six-month period ended June 30, 2007 were \$344.3 million at an effective interest rate of 7.17% as compared to weighted-average borrowings of \$416.5 million at an effective interest rate of 7.09% for the six-month period ended July 1, 2006.

At June 30, 2007, we had approximately \$343.3 million in term loan borrowings and no borrowings outstanding under our revolver, exclusive of approximately \$23.4 million of outstanding letters of credit. Principal borrowings under our term loan are due and payable in quarterly installments of \$0.9 million through June 30, 2012 with the remaining balance of \$325.8 million due on July 14, 2012.

Our senior credit facility requires us to hedge at least 25% of our variable rate debt under the term loan. On September 22, 2005, we entered into a swap agreement to receive floating interest and pay fixed interest. This swap agreement is designated as a cash flow hedge of the variable interest payments on a portion of our variable rate term loan debt. The swap agreement matures on July 30, 2010. As of June 30, 2007, approximately \$156.9 million of our outstanding term loan debt was hedged under this agreement.

On May 25, 2006, we entered into an interest rate collar agreement (the collar) with a floor of 4.3% and a ceiling of 5.5%. The collar covers \$100 million of our variable rate term loan debt and is designated as a cash flow hedge of the variable interest payments on such debt. The collar matures on January 31, 2009.

Our senior credit facility also sets forth mandatory and optional prepayment conditions, including an annual excess cash flow requirement, as defined, that may result in our use of cash to reduce our debt obligations. No such prepayment was required for fiscal 2006.

Based on our current level of operations, we believe that cash generated from operations and available cash, together with amounts available under our revolver, will be adequate to meet our debt service requirements, capital expenditures, and working capital needs for the foreseeable future, although no assurance can be given in this regard. We may, however, need to refinance all or a portion of the principal amount of amounts outstanding under our revolver on or before July 14, 2011 and amounts outstanding under our term loan on or before July 14, 2012.

EFFECTS OF INFLATION AND DEFLATION

We are affected by inflation and changing prices primarily through purchasing product from our global suppliers, increased operating costs and expenses, and fluctuations in interest rates. The effects of inflation on our net sales and operations have not been material in recent years. In recent years, there has been deflationary pressure on selling prices. While we have been successful in offsetting such deflationary pressures through product improvements and lower costs with the expansion of our global sourcing network, if deflationary price trends outpace our ability to obtain further price reductions from our global suppliers, our profitability may be affected.

SEASONALITY

We experience seasonal fluctuations in our sales and profitability, with generally lower sales and gross profit in the first and second quarters of our fiscal year. Over the past five fiscal years, excluding the impact of the Acquisition in fiscal 2005, approximately 57% of our consolidated net sales were generated in the second half of our fiscal year. Accordingly, our results of operations for the first and second quarters of any year are not indicative of the results we expect for the full year.

As a result of this seasonality, our inventory levels and other working capital requirements generally begin to increase during the second quarter and into the third quarter of each year. During these peak periods we have historically borrowed under our revolving credit facility.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our significant accounting policies are described in Note 2 to our audited consolidated financial statements contained in our most recently filed Annual Report on Form 10-K. The following discussion addresses our critical accounting policies and estimates, which are those policies that require management's most difficult and subjective judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Revenue recognition: We recognize wholesale and mass channel revenue after shipment of products to customers, when title passes, when all risks and rewards of ownership have transferred, the sales price is fixed or determinable, and collectibility is reasonably assured. In certain cases, in which we retain the risk of loss during shipment, revenue recognition does not occur until the goods have reached the specified customer. In the normal course of business, we grant certain accommodations and allowances to our wholesale and mass channel customers in order to assist these customers with inventory clearance and promotions. Such amounts are reflected as a reduction of net sales and are recorded based upon historical trends and annual forecasts. Retail store revenues are recognized at the point of sale. We reduce revenue for customer returns and deductions. We also maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make payments and other actual and estimated deductions. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required. Past due balances over 90 days are reviewed individually for collectibility. Our credit and collections department reviews all other balances regularly. Account balances are charged off against the allowance when we feel 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 and mass channel customers. Such fair value is determined based upon, among other factors, comparable market analysis for similar advertisements. In accordance with Emerging Issues Task Force Issue No. 01-09, Accounting for Consideration Given by a Vendor to a Customer/Reseller, we have included the fair value of these arrangements of approximately \$0.1 million and \$0.6 million in the second quarter and the first half of fiscal 2007 and \$0.4 million and \$1.5 million in the second quarter and first half of fiscal 2006 as a component of selling, general, and administrative expenses in 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 those we project, additional write-downs may be required.

Cost in excess of fair value of net assets acquired and tradename: As of June 30, 2007, we had approximately \$446.8 million in Carter's cost in excess of fair value of net assets acquired and Carter's and OshKosh tradename assets. The fair value of the Carter's tradename was estimated at the 2001 acquisition to be approximately \$220.2 million using a discounted cash flow analysis, which examined the hypothetical cost savings that accrue as a result of our ownership of the tradename. The fair value of the OshKosh tradename is currently estimated to be approximately \$90.0 million, also using a discounted cash flow analysis. The cash flows, which incorporated both historical and projected financial performance, were discounted using a discount rate of 10% and 12% for Carter's and OshKosh, respectively. The tradenames were determined to have indefinite lives. The carrying value of these assets is subject to annual impairment reviews as of the last day of each fiscal year. Factors affecting such impairment reviews include the continued market acceptance of our offered products and the development of new products. Impairment reviews may also be triggered by any significant events or changes in circumstances.

Accrued expenses: Accrued expenses for health insurance, workers' compensation, incentive compensation, 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.

Accounting for income taxes: As part of the process of preparing our consolidated financial statements, we are required to estimate our actual current tax exposure (state, federal, and foreign), together with assessing 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, 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 statements of operations.

Stock-based compensation arrangements: The Company accounts for stock-based compensation in accordance with the fair value recognition provisions of SFAS No. 123 (revised 2004), Share-Based Payment. 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 since the Company's initial public offering on October 29, 2003, supplemented by peer company data for periods prior to our initial public offering 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.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of our 2008 fiscal year. We are currently evaluating the impact that SFAS 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159), which provides entities with an option to report selected financial assets and liabilities at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. This statement is effective as of the beginning of the first fiscal year that begins after November 15, 2007. We are currently evaluating the impact that SFAS 159 will have on our consolidated financial statements.

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 2007 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

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 the Far East and South and Central America. While these contracts are stated in United States dollars, there can be no assurance that the cost for the future production of our products will not be affected by exchange rate fluctuations between the United States dollar and the local currencies of these contractors. Due to the number of currencies involved, we cannot quantify the potential impact of future currency fluctuations on net (loss) income in future years. In order to manage this risk, we source products from approximately 100 vendors worldwide, providing us with flexibility in our production should significant fluctuations occur between the United States dollar and various local currencies. To date, such exchange fluctuations have not had a material impact on our financial condition or results of operations. We do not hedge foreign currency exchange rate risk.

Our operating results are subject to risk from interest rate fluctuations on our senior credit facility, which carries variable interest rates. As of June 30, 2007, our outstanding debt aggregated \$343.3 million, of which \$86.4 million bore interest at a variable rate. An increase of 1% in the applicable rate would increase our annual interest cost by \$0.9 million, exclusive of variable rate debt subject to our swap and collar agreements, and could have an adverse effect on our net (loss) income and cash flow.

OTHER RISKS

There are also other risks in the operation of our business specifically related to our global sourcing network.

We enter into various purchase order commitments with full-package 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. Historically, such cancellations and related termination charges have not had a material impact on our business. However, as we rely nearly exclusively on our full-package global sourcing network, we expect to incur more of these termination charges, which could increase our cost of goods sold.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

(b) 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.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS:

N/A

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 Securities and Exchange Commission 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 impair our business operations. If any of the following risks actually occur, our operating results may be affected.

Risks Relating to Our Business

The loss of one or more of our major customers could result in a material loss of revenues.

In the second quarter and first half of fiscal 2007, we derived approximately 44.3% and 45.7% of our consolidated net sales from our top eight customers, including mass channel customers. Wal-Mart accounted for approximately 13% of our consolidated net sales for the second quarter and first half of fiscal 2007. We expect that these customers will continue to represent a significant portion of our sales in the future. However, we do not enter into long-term sales contracts with our major customers, relying instead on long-standing relationships with these customers 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 its or their business with us or terminate its or their relationships with us. Any such decrease or termination of our major customers' business could result in a material decrease in our sales and operating (loss) income.

The acceptance of our products in the marketplace is affected by consumers' tastes and preferences, along with fashion trends.

We believe that continued success depends on our ability to provide a unique and compelling value proposition for our consumers in the Company's distribution channels. There can be no assurance that the demand for our products will not decline, or that we will be able to successfully evaluate and adapt our product to be aware of consumers' tastes and preferences and 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 affect on our sales, gross margin, and results of operations.

The value of our brand, and our sales, could be diminished if we are associated with negative publicity.

Although our employees, agents, and third-party compliance auditors periodically visit and monitor the operations of our vendors, independent manufacturers, and licensees, we do not control these vendors, independent manufacturers, licensees, or their labor practices. A violation of our vendor policies, licensee agreements, labor laws, or other laws by these vendors, independent manufacturers, or licensees could interrupt or otherwise disrupt our supply chain or damage our brand image. As a result, negative publicity regarding our Company, brands, or products, including licensed products, could adversely affect our reputation and sales.

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The security of the Company's databases that contain personal information of our retail customers could be breached, which could subject us to adverse publicity, litigation, and expenses. In addition, if we are unable to comply with security standards created by the credit 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 the credit card industry, we may be subject to fines, restrictions, and expulsion from card acceptance programs, which could adversely affect our retail operations.

The Company's royalty income is greatly impacted by the Company's brand reputation.

The Company's brand image, which is associated with providing a consumer product with outstanding quality and name recognition, makes it valuable as a royalty source. The Company is able to license complementary products and obtain royalty income from use of its *Carter's*, *Child of Mine*, *Just One Year*, *OshKosh*, *Genuine Kids from OshKosh*, and related trademarks. The Company also generates foreign royalty income as our *OshKosh B'Gosh* label carries an international reputation for quality and American style. While the Company takes significant steps to ensure the reputation of its brand is maintained through its license agreements, there can be no guarantee that the Company's brand image will not be negatively impacted through its association with products outside of the Company's core apparel products.

There are deflationary pressures on the selling price of apparel products.

In part due to the actions of discount retailers, and in part due to the worldwide supply of low cost garment sourcing, the average selling price of children's apparel continues to decrease. To the extent these deflationary pressures are offset by reductions in manufacturing costs, there is a modest affect on the gross margin percentage. However, the inability to leverage certain fixed costs of the Company's design, sourcing, distribution, and support costs over its gross sales base could have an adverse impact on the Company's operating (loss) income.

Our business is sensitive to overall levels of consumer spending, particularly in the apparel segment.

The Company believes that spending on children's apparel is somewhat discretionary. While certain apparel purchases are less discretionary due to size changes as children grow, the amount of clothing consumers desire to purchase, specifically brand name apparel products, is impacted by the overall level of consumer spending. Overall economic conditions that affect discretionary consumer spending include employment levels, gasoline and utility costs, business conditions, tax rates, interest rates, and levels of consumer indebtedness. Reductions in the level of discretionary spending or shifts in consumer spending to other products may have a material adverse affect 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, 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 in the Far East, coordinated by our Far East 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:

- political instability or other international events resulting in the disruption of trade in foreign countries from which we source our products;
- the imposition of new regulations relating to imports, duties, taxes, and other charges on imports including the China safeguards;
- the occurrence of a natural disaster or an epidemic, the spread of which may impact our ability to obtain products on a timely basis;
- changes in U.S. Customs procedures concerning the importation of apparel products;
- unforeseen delays in customs clearance of any goods;
- disruption in the global transportation network such as a port strike, world trade restrictions, or war;
- the application of foreign intellectual property laws; and
- exchange rate fluctuations between the United States dollar and the local currencies of foreign contractors.

These and other events beyond our control could interrupt our supply chain and delay receipt of our products into the United States.

We 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 revenues and gross profit.

The baby and young children's apparel market is highly competitive. Both branded and private label manufacturers compete in the baby and young children's apparel market. Our primary competitors in our wholesale and mass channel businesses include Disney, Gerber, and private label product offerings. Our primary competitors in the retail store channel include Old Navy, The Gap, The Children's Place, Gymboree, and Disney. Because of the fragmented nature of the industry, we also compete with many other manufacturers and retailers. Some of our competitors have greater financial resources and larger customer bases than we have and are less financially leveraged than we are. As a result, these competitors may be able to:

- adapt to changes in customer requirements more quickly;
- take advantage of acquisition and other opportunities more readily;
- devote greater resources to the marketing and sale of their products; and
- adopt more aggressive pricing strategies than we can.

The Company's retail success and future growth is dependent upon identifying locations and negotiating appropriate lease terms for retail stores.

The Company's retail stores are located in leased retail locations across the country. Successful operation of a retail store depends, in part, on the overall ability of the retail location to attract a consumer base sufficient to make store sales volume profitable. If the Company is unable to identify new retail locations with consumer traffic sufficient to support a profitable sales level, retail growth may consequently be limited. Further, if existing outlet centers do not maintain a sufficient customer base that provides a reasonable sales volume, there could be a material adverse impact on the Company's sales, gross margin, and results of operations.

Our substantial leverage could adversely affect our financial condition.

On June 30, 2007, we had total debt of approximately \$343.3 million.

Our substantial indebtedness could have negative consequences. For example, it could:

- increase our vulnerability to interest rate risk;
- limit our ability to obtain additional financing to fund future working capital, capital expenditures, and other general corporate requirements, or to carry out other aspects of our business plan;
- require us to dedicate a substantial portion of our cash flow from operations to pay principal of, and interest on, our indebtedness, thereby reducing the availability of that cash flow to fund working capital, capital expenditures, or other general corporate purposes, or to carry out other aspects of our business plan;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry; and
- place us at a competitive disadvantage compared to our competitors that have less debt.

In addition, our senior credit facility contains financial and other restrictive covenants that may limit our ability to engage in activities that may be in our long-term best interests such as selling assets, strategic acquisitions, paying dividends, and borrowing additional funds. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our debt which could leave us unable to meet some or all of our obligations.

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.

In connection with the 2001 acquisition of the Company by investment funds affiliated with Berkshire Partners LLC, we recorded cost in excess of fair value of net assets acquired of \$136.6 million and a *Carter's* brand tradename asset of \$220.2 million. Additionally, in connection with the Acquisition of OshKosh, we recorded cost in excess of fair value of net assets acquired of \$142.9 million and a tradename asset of \$102.0 million. 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. During the second quarter of fiscal 2007, the Company performed an interim impairment review of the OshKosh intangible assets due to continued negative trends in sales and profitability of the Company's OshKosh wholesale and retail segments and the re-forecasted projections for such segments for the balance of fiscal 2007. As a result of this review, the Company wrote off our OshKosh cost in excess of fair value net assets acquired asset of \$142.9 million and wrote down the *OshKosh* tradename by \$12.0 million. Estimated future cash flows used in these impairment reviews could be negatively impacted if we do not achieve our sales growth plans, planned cost savings, and other assumptions that support the carrying value of these intangible assets, which could result in potential impairment of the remaining asset value.

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.

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

The following table provides information about purchases by the Company during the three-month period ended June 30, 2007, of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs (1) | Approximate dollar value of shares that may yet be purchased under the plans or programs (1) |
|--------------------------------------|----------------------------------|------------------------------|--|--|
| April 1, 2007 through April 28, 2007 | | \$ | | \$ 69,999,877 |
| April 29, 2007 through May 26, 2007 | 394,587 | (2)\$ 25.37 | 394,587 | \$ 59,988,041 |
| May 27, 2007 through June 30, 2007 | | \$ | | \$ 59,988,041 |
| Total | 394,587 | \$ 25.37 | 394,587 | \$ 59,988,041 |

(1) On February 16, 2007, our Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to \$100 million of its outstanding common shares. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, and other factors. This program was announced in the Company's report on Form 8-K, which was filed on February 21, 2007. The total remaining authorization under the repurchase program was \$59,988,041 as of June 30, 2007.

(2) Represents repurchased shares which were retired.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES:

N/A

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS:

The Company held its Annual Meeting of Stockholders on May 11, 2007 (the Annual Meeting) for which proxies were solicited pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended. The following matter was voted on by the Company's stockholders:

David Pulver and Elizabeth A. Smith were re-elected as Class I directors to each serve for a three-year term. The following is a schedule of the votes cast:

| Nominee | Total votes for | Total votes withheld |
|--------------------|--------------------|-------------------------|
| David Pulver | 49,284,486 | 963,640 |
| Elizabeth A. Smith | 49,983,112 | 265,014 |

The directors continuing to serve after the Annual Meeting were: Class I directors - David Pulver and Elizabeth A. Smith, Class II directors - Bradley M. Bloom and Frederick J. Rowan, II, and Class III directors - Paul Fulton, John R. Welch, and Thomas E. Whiddon.

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: August 9, 2007

/s/ FREDERICK J. ROWAN, II
Frederick J. Rowan, II
*Chairman of the Board of Directors and
Chief Executive Officer*

Date: August 9, 2007

/s/ MICHAEL D. CASEY
Michael D. Casey
*Executive Vice President and
Chief Financial Officer*

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