MERGE HEALTHCARE INC
Form 10-K
February 27, 2015

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

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 001-33006

MERGE HEALTHCARE INCORPORATED
(Exact name of Registrant as specified in its charter)

Delaware	39-1600938
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

350 North Orleans Street, 1st Floor
Chicago, Illinois 60654
(Address of principal executive offices, including zip code)
(Registrant's telephone number, including area code) (312) 565-6868
Securities registered under Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value per share	The NASDAQ Global Select Market

Securities registered under Section 12(g) of the Exchange Act: NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value for the Registrant's voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2014, based upon the closing sale price of the Common Stock on June 30, 2014, as reported on The NASDAQ Global Select Market, was approximately $155,662,238. Shares of Common Stock held by each officer and director and by each person who owns ten percent or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant's common stock, par value $0.01 per share, as of February 25, 2015: 98,456,765

DOCUMENTS INCORPORATED BY REFERENCE

Certain of the information required by Part III is incorporated by reference from the Registrant's Proxy Statement for its 2015 Annual Meeting of Stockholders.

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PART I

This Annual Report on Form 10 K and other written or oral statements made by us or on our behalf may include forward-looking statements that reflect our current views with respect to future events and future financial performance. Certain statements in this Annual Report on Form 10-K are "forward-looking statements." You can identify these forward-looking statements by our use of the words "believes," "anticipates," "forecasts," "projects," "could," "plans," "expects," "may," "will," "would," "intends," "estimates" and similar expressions, whether in the negative or affirmat We wish to caution you that any forward-looking statements made by us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. We cannot guarantee that we actually will achieve these plans, intentions or expectations. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make and we cannot guarantee future results, levels of activity, and/or performance. We do not assume any obligation to update or revise any forward-looking statements that we make, whether as a result of new information, future events or otherwise.

Factors that may impact forward-looking statements include, among others, the risks and other matters set forth in the section entitled "Item 1A Risk Factors" in this Annual Report on Form 10-K. Although we have attempted to list comprehensively these important factors, we also wish to caution investors that other factors may prove to be important in the future in affecting our business and operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or combination of factors may have on our business.

Unless otherwise indicated by the context, references to "we" include Merge Healthcare Incorporated and its consolidated subsidiaries.

Item 1. BUSINESS

Overview

We develop software solutions that facilitate the sharing of images to create a more effective and efficient electronic healthcare experience for patients and physicians. Our solutions are designed to help solve some of the most difficult challenges in health information exchange today, such as the incorporation of medical images and diagnostic information into broader healthcare IT applications, the interoperability of proprietary software solutions, the profitability of outpatient imaging practices and the ability to improve the efficiency and cost effectiveness of our customers' businesses.

We are a Delaware corporation that was founded in 1987. Our principal executive offices are located at 350 North Orleans Street, 1st Floor, Chicago, Illinois, 60654, and our telephone number there is (312) 565-6868.

Our website address, which we use to communicate important business information, can be accessed at: www.merge.com. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports available free of charge on or through our website as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC). References to our website addressed in this Annual Report on Form 10-K are provided as a convenience and do not constitute, and should not be viewed as, an incorporation by reference of the information contained on, or available through, the website. Therefore, such information should not be considered part of this Annual Report on Form 10-K. Materials we file with or furnish to the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. Also, the SEC Internet website (www.sec.gov) contains reports, proxy and information statements, and other information that we file electronically with the SEC.

Our solutions optimize processes for healthcare providers ranging in size from single provider practices to large health systems, to the sponsors of clinical trials and medical device manufacturers. We operate under two reportable segments: Merge Healthcare and Merge DNA. Our Merge Healthcare segment represents approximately 85% of our total revenues and markets, sells and implements interoperability, imaging and clinical solutions to healthcare providers. Our Merge DNA (Data and Analytics) segment represents approximately 15% of our total revenues and focuses on the marketing and sale of data capture software for clinical trials and related solutions. We evaluate the performance of each operating segment based on its respective revenues and operating income.

Our Merge Healthcare segment primarily generates revenue from the licensing of software (including upgrades), the sale of hardware, professional services, maintenance and electronic data interchange (EDI) services. Our Merge DNA segment generates revenue from software, through both on-premise licensing and hosting arrangements, and professional services. Going forward, we expect the vast majority of revenues of Merge DNA will come from hosted clinical trial arrangements.

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Healthcare IT Industry

We believe there are several factors that may be favorable for the healthcare IT industry over the next few years, most notably the expected rate of growth in domestic healthcare spending. The Centers for Medicare and Medicaid Services (CMS) estimates U.S. healthcare spending in 2014 at $3.1 trillion, or 17.6% of Gross Domestic Product (GDP), and projects it to be 19.3% of GDP by 2023.

The American Recovery and Reinvestment Act (ARRA) and accompanying Health Information Technology for Economic and Clinical Health (HITECH) provisions included more than $35 billion in incentives which reward providers who provide for “meaningful use” of certified electronic health records (EHRs). These incentives may contribute to increased demand for a broader segment of healthcare IT solutions and services in the United States.

Imaging is an essential component of healthcare delivery across the continuum of care. As both Medicare and private payers move more rapidly towards outcomes-based reimbursement, including Accountable Care Organizations (ACOs) and shared savings models, we believe the need for image management and image sharing solutions will grow significantly.

We believe that we are positioned to provide value added solutions and services to our customers amidst potential changes in industry standards and regulations. We believe the fundamental value proposition of healthcare IT remains strong and that the industry will likely benefit as healthcare providers and governments continue to recognize that these solutions and services contribute to safer, more efficient healthcare delivery.

Merge Growth Strategy

Our strategy is to be a leading provider of enterprise imaging and interoperability solutions and services that improve the exchange of healthcare information. We believe the growth drivers for Merge are the importance of imaging and the need for interoperability between providers and other healthcare constituents.

Our portfolio of technologies is used across a wide variety of clinical specialties in addition to being an increasingly important component of clinical trials. For example, our iConnect platform offers hospitals and imaging centers the ability to electronically manage in-bound medical imaging referrals and distribution of results to referring physicians without having to build expensive point-to-point HL7 interfaces.

We have an opportunity to cross-sell products to existing customers as only a small percentage currently have more than one of our enterprise solutions. This is evidenced by the fact that no customer accounted for more than 10% of our net sales in any of the last three years. With the benefit of a broad customer base and several product lines undergoing ongoing innovation, we intend to continue to leverage technologies into new segments where customers see value.

Our Product Portfolio

We provide a broad range of products and services to our customers, including:

- Image Interoperability Platform

  - iConnect Enterprise Archive; iConnect Access Enterprise Viewer: An interoperability and connectivity platform that enables hospitals, imaging centers, Integrated Delivery Networks and HIEs to create image archives and exchanges within their environments and with other entities. This platform provides access to imaging and diagnostic data across disparate sites, geographies, specialties and providers. This enables providers to expedite care, reduce duplicate exams, consolidate infrastructure and limit the expenses associated with moving, managing and storing diagnostic content and results.

- iConnect Network: An advanced interoperability network that allows hospitals and imaging centers to electronically manage in-bound medical imaging referrals and distribution of results to referring physicians without having to build expensive point-to-point HL7 interfaces.

- iConnect Cloud Archive (formerly known as Merge Honeycomb Archive:):A cloud-based, multi-tenant image archive that provides disaster recovery/business continuity services for hospitals, imaging centers, and physician practices.

- iConnect Retinal Screening: An end-to-end software solution for the screening of chronic visual diseases. This solution allows providers to have easy access to highly specialized eye care.

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- Clinical and Financial Information Systems

  - Digital Imaging Solutions: Picture Archiving and Communication Systems (PACS), specialty workstations and related applications manage the image workflow of a medical enterprise. PACS can be used by any medical imaging provider at a hospital or outpatient imaging site. We offer PACS solutions for general image review and management, specialty solutions for cardiology, orthopedics, ophthalmology, mammography and oncology, and add-on modules like referring physician portals and critical test results reporting. We also offer our eFilm Workstation for general radiology reading and CADstream workstations for specialty reading of magnetic resonance imaging (MRI) breast, liver and prostate studies.

  - Clinical information systems: These systems provide a complete electronic record of a medical procedure across a variety of specialties – including Merge OrthoEMR for orthopedics and Merge RIS for radiology.

  - Revenue Cycle Management: We offer software and services for the revenue cycle management of physician practices. These solutions can be used across many physician specialties, but our solutions are most commonly used by radiology practices, imaging centers and billing services.

  - Merge One: A cloud-based radiology solution for ambulatory imaging businesses to power a practice's entire workflow.

- Software Development Toolkits, Technologies and Platforms.

  - Merge toolkits, technologies and platforms provide software developers with the necessary resources to assist in the timely development of new products and enhance existing products. They can be used by original equipment manufacturers (OEMs), medical device manufacturer, RIS/PACS or general healthcare IT vendors. We offer development toolkits in the basic standards of medical imaging and information interoperability, as well as advanced toolkits and unfinished applications for specialized medical image review and distribution.

- Hosted Software Solutions for Clinical Trial Data Management.

  - We provide hosted software solutions for the collection, aggregation, analysis, reporting and overall management of clinical trials information. These solutions can be sold to sponsors of clinical trials, including pharmaceutical companies, contract research organizations (CRO) or imaging core labs. Our solutions include electronic data capture (EDC), interactive voice/web response (IVR/IWR) and electronic patient reported outcomes (ePRO) software and devices.

Backlog

At the end of 2014, we had software and professional services backlog, both licensed and hosted, of $76.0 million as compared to $80.1 million at the end of 2013. This backlog represents revenue from signed contracts that has not yet been recognized. Due to the variability in timing and length of maintenance renewals, we do not track maintenance backlog.

Competition

The healthcare IT and imaging markets in which we participate are highly competitive, rapidly evolving and subject to rapid technological change.

Our principal competitors in the healthcare solutions and services market include: General Electric, McKesson Corporation, Fuji, Philips, Carestream, and Agfa, each of which offers software solutions that compete with a portion of our product portfolio. Almost all of these competitors are substantially larger or have more experience and market share than Merge in their respective markets. We also partner with certain of these companies.

Other competitors focus on specific portions of the market that we address or compete against specific products we sell. For example, there are 30 other companies in the North American PACS market, according to Frost & Sullivan. These companies include original equipment manufacturers, former film companies and healthcare IT companies. Our eClinical solutions and services are in a highly competitive market led by Oracle and Medidata. Our OEM technologies most often compete with internal development departments, but also compete with software development companies for our Digital Imaging and Communications in Medicine (DICOM) and HL7 toolkits.

In addition, major software information systems companies, large information technology consulting service providers and system integrators, start-up companies, managed care companies and others that specialize in the healthcare industry offer competitive software solutions or services. The pace of change in the healthcare IT market is rapid and there are frequent new software solutions or service introductions, enhancements and evolving industry standards and requirements. We believe that the principal competitive factors in this market include the breadth and quality of solution and service offerings, the stability of the solution provider, the quality, features and performance of the products, the ongoing support for the systems and the potential for enhancements and future compatible software solutions.

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Employees

At December 31, 2014, we had approximately 800 employees worldwide. Competition for personnel in the industry in which we compete is intense. We believe that our future success depends in part on our continued ability to hire, assimilate, train and retain qualified personnel.

Software Development

We commit significant resources to developing new health information system solutions. At December 31, 2014, approximately 200 of our employees were engaged in research and development activities. Total expenditures for the development and enhancement of our solutions, including capitalized software costs, were approximately $32.7 million, $32.4 million and $32.4 million during 2014, 2013 and 2012, respectively.

Our products, ranging from standards-based development toolkits to fully integrated clinical applications, have been used by healthcare providers worldwide for over 20 years. Our software solutions follow industry standards such as DICOM, which ensures that images from any DICOM-compliant imaging modality can be displayed, moved and stored within a standard set of guidelines. In addition, Merge follows the guidelines of the Integrating the Healthcare Enterprise (IHE) standards body, an organization dedicated to developing standard profiles for health information exchange. Our long-time involvement with the standards committees and continuous development of products like our DICOM and HL7 toolkits have enabled Merge to stay closely tied to industry innovation. As discussed above, continued investment in research and development remains a core element of our strategy. This will include ongoing enhancement of our core solutions and development of new solutions and services such as iConnect Cloud Archive, our cloud-based platform and iConnect Network, our new image and data exchange network.

Patents, Trademarks, Copyrights and Trade Secrets

We regard our intellectual property as important to our success. We have a portfolio of U.S. and international patents, trademarks, service marks, copyrights and trade secrets covering our products and services. Our proprietary technology is not dependent on any single patent or copyright or groups of related patents or copyrights. Our business is not dependent on any single patent, copyright or other form of intellectual property. We believe the term of each of our patents is adequate relative to the expected lives of our products. We rely on trademark, copyright, patent and trade secret law, and utilize confidentiality, license and other agreements with employees, customers and others to protect our proprietary rights.

We hold inbound licenses for certain intellectual property that is used internally, and in some cases, utilized in our products or services. While it may be necessary in the future to seek or renew licenses relating to various aspects of our products and services, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our operations and products and services are not materially dependent on any single license or other agreement with any third party.

Sales, Marketing and Distribution

Sales to large health systems typically require a minimum of nine months of development time, while the sales cycle can be shorter when selling to smaller hospitals and imaging centers. At December 31, 2014, approximately 135 of our employees were engaged in sales and marketing activities. Our executive sales and marketing management is located in Chicago, Illinois, while our sales team is deployed across the U.S. and globally.

We employ quota based sales teams that specialize in particular solutions and services. In addition, we have sales teams dedicated to establishing and maintaining distributor relationships on a global basis. We have concentrated inside and telesales staff in one location in order to bring economies of scale in management and process. Our sales teams are complemented by a staff of lead generation and marketing employees. These teams use online tools and resources that streamline and track the sales process.

Our marketing efforts are mainly electronic, utilizing our website and our extensive email database of customers for our communication campaigns, as well as our website for online communities and certain social media. Beyond electronic media, we employ consistent media relations efforts for market communications. In addition, we participate in the major industry trade shows for our respective product lines. We also have an active user group for our U.S. customers and an industry advisory board.

Financial Information about Segments

For financial information regarding our two operating groups as well as our geographic areas of operation, refer to Item 8, “Note 1 – Basis of Presentation and Significant Accounting Policies” and “Note 14 – Segment Information and Concentrations of Risk” of this Annual Report on Form 10-K.

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Item 1A. RISK FACTORS

Discussion of our business and operating results included in this annual report on Form 10-K should be read together with the risk factors set forth below. They describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties, together with other factors described elsewhere in this report, have the potential to affect our business, financial condition, results of operations, cash flows, strategies, prospects, or the market price of our common stock in a material and adverse manner. New risks may emerge at any time, and we cannot predict those risks or estimate the extent to which they may affect financial performance. We undertake no obligation to update or revise the statements.

Reductions in Medicare and Medicaid Reimbursement Rates for Imaging Procedures and Professional Services or Delays in the Payment of Reimbursements could Negatively Affect Revenues of our Hospital and Imaging Clinic Customers, which could cause our Customers to Reduce or Delay Purchases of our Software and Services.

The ability of customers to obtain appropriate reimbursement for their services from these programs and payors is critical to our success. Reductions in the amount of reimbursements or uncertainty or delays in those reimbursements have in the past, and could in the future, cause our customers to cancel or delay making new expenditures on healthcare IT. Federal budget reductions can affect the timing of the sales of our software and services.

In addition, the U.S. Congress has enacted far-reaching health system reform legislation that could have a negative impact on our business. While the impact of the legislation is difficult to predict, the legislation will increase pressure to control spending in government programs (e.g., Medicare and Medicaid) and by third party payors. For example, changes in the equipment utilization rate, once fully implemented, have the potential to decrease technical reimbursements for radiology procedures, and could have a particularly negative impact on hospitals and imaging clinics in rural regions of the country where utilization rates are naturally lower. A second significant potential reimbursement change relates to the Sustainable Growth Rate (SGR) component of the Medicare Physician Fee Schedule. The SGR is part of the update factor process used to set the annual rate of growth in allowed reimbursable medical expenditures, and is determined by a formula specified by Congress. Because the annual calculation of the SGR would have led to reimbursement reductions that Congress found unacceptable, Congress has interceded on an annual basis to delay the implementation of this statutory SGR update factor. While these changes have provided temporary reimbursement relief to healthcare providers and us, because of the significant budgetary impacts, Congress has retained the SGR formula, thereby allowing annual unimplemented payment reductions to accumulate in the Medicare statute. The current SGR fix delay expires in March, and there are again various proposals to implement a permanent fix. The changes being considered have the potential to negatively impact the professional component of any reimbursement system. In addition, the SGR delay legislation contained many additional reimbursement provisions, such as the mandate to delay the implementation of ICD-10 for one year.

Annual changes related to CMS reimbursement inputs and the SGR calculation could result in a reduction in software and service procurement of our customers, and have a material adverse effect on our revenues and operating results.

We are Subject to Government Regulation, Changes to which could Negatively Impact our Business.

We are subject to regulation in the U.S. by the Food and Drug Administration (FDA), including periodic FDA inspections, in Canada under Health Canada’s Medical Devices Regulations, and in other countries by corresponding regulatory authorities. We may be required to undertake additional actions in the U.S. to comply with the Federal Food, Drug and Cosmetic Act (FDCA), regulations promulgated under the FDCA, and any other applicable regulatory requirements. For example, the FDA has increased its focus on regulating computer software intended for use in a healthcare setting. If our software solutions are deemed to be actively regulated medical devices by the FDA, we could be subject to more extensive requirements governing pre- and post-marketing activities. Complying with these regulations could be time consuming and expensive, and may include:

- Requiring us to receive FDA clearance of a pre-market notification submission demonstrating substantial equivalence to a device already legally marketed, or to obtain FDA approval of a pre-market approval application establishing the safety and effectiveness of the software;

- Requiring us to comply with rigorous regulations governing the pre-clinical and clinical testing, manufacture, distribution, labeling and promotion of medical devices; and

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- Requiring us to comply with the FDCA regarding general controls, including establishment registration, device listing, compliance with good manufacturing practices, reporting of specified malfunctions and adverse device events.

Similar obligations may exist in other countries in which we do business, including Canada. Any failure by us to comply with other applicable regulatory requirements, both domestic and foreign, could subject us to a number of enforcement actions, including warning letters, fines, product seizures, recalls, injunctions, total or partial suspensions of production, operating restrictions or limitations on marketing, refusals of the government to grant new clearances or approvals, withdrawals of marketing clearances or approvals and civil and criminal penalties.

We are subject to periodic FDA inspections and there can be no assurances that we will not be required to undertake additional actions to comply with the FDCA and any other applicable regulatory requirements. Any failure by us to comply with the FDCA and any other applicable regulatory requirements could have a material adverse effect on our ability to continue to manufacture and distribute our software solutions. The FDA has many enforcement tools including recalls, seizures, injunctions, civil fines and/or criminal prosecutions. Any of the foregoing could have a material adverse effect on our business, results of operations or financial condition.

Changes in Federal and State Regulations Relating to Handling of Data and Data Privacy could Depress the Demand for our Software and Impose Significant Software Redesign Costs.

Federal regulations under the Health Insurance Portability and Accountability Act (HIPAA) impose national health data standards on healthcare providers that conduct electronic health transactions, healthcare clearinghouses that convert health data between HIPAA compliant and non-compliant formats and health plans. Collectively, these groups are known as covered entities. HIPAA regulations prescribe transaction formats and code sets for electronic health transactions, protect individual privacy by limiting the uses and disclosures of individually identifiable health information and require covered entities to implement administrative, physical and technological safeguards to ensure the confidentiality, integrity, availability and security of individually identifiable health information in electronic form. Although we are not a covered entity, most of our customers are, and they require that our software and services adhere to HIPAA regulations. Any failure or perceived failure of our software or services to meet HIPAA regulations, or any breach of the HIPAA regulations or any other federal, state or foreign data privacy laws or regulations, could result in remediation costs and fines, and could adversely affect demand for our software and services and potentially require us to expend significant capital, research and development and other resources to modify our software or services to address the privacy and security requirements of our clients.

States and foreign jurisdictions have adopted, or may adopt, privacy standards that are similar to or more stringent than the federal HIPAA privacy regulations. This may lead to different restrictions for handling individually identifiable health information. As a result, our customers may demand IT solutions and services that are adaptable to reflect different and changing regulatory requirements, which could increase our development costs. In the future, federal, state or foreign governmental authorities may impose new data security regulations or additional restrictions on the collection, use, transmission and other disclosures of health information. We cannot predict the potential impact that these future rules may have on our business; however, the demand for our software and services may decrease if we are not able to develop and offer software and services that can address the regulatory challenges and compliance obligations facing our clients.

Our Business could be Harmed by Adverse General Economic and Market Conditions.

Our markets have been and will continue to be affected by general economic and market conditions. If general economic conditions deteriorate or economic uncertainty continues in the markets in which we do business, our clients might experience deterioration of their businesses, cash flow shortages and difficulty obtaining financing which may impact the decisions of customers to purchase products that improve their processes and delay or reduce their purchases, and in our having higher customer receivables with increased default rates. General concerns about the fundamental soundness of domestic and foreign economies may also cause customers to reduce their purchases, even if they have cash or if credit is available to them. This could result in reductions in sales of our products, longer sales cycles, slower adoption of new technologies and increased price competition. In addition, weakness in the end-user market could negatively affect our OEM and VAR customers who could, in turn, delay paying their obligations, which would increase our credit risk exposure and cause a decrease in operating cash flows. Also, if OEM and VAR customers experience excessive financial difficulties and/or insolvency, and we are unable to successfully transition end-users to purchase products from other vendors or directly from us, sales could decline. Any of these events would likely harm our business, results of operations and financial condition.

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The Financial Covenants in our Credit Agreement Dated April 29, 2014 (Credit Agreement), may Force Us to Take Certain Actions that Could Adversely Affect our Future Results of Operations.

The Credit Agreement contains a leverage ratio covenant and an interest coverage ratio covenant in future periods. Our ability to satisfy these financial covenants going forward will depend on our future operating performance, which is in part subject to prevailing economic and competitive conditions and various financial, business, legislative, regulatory and other factors, some of which are beyond our control. If we cannot, or expect that we may not, meet the Credit Agreement's financial covenants in the future, we may need to dispose of material assets or operations, reduce or delay investments and capital expenditures, seek additional equity capital investments or negotiate to restructure or refinance our indebtedness with our lenders. We may not be able to affect any such alternative measures on commercially reasonable terms or at all. Even if successful, such alternative measures may not allow us to meet the financial covenants in future periods, and/or they could limit our ability to realize the value of our assets and opportunities, restrict our ability to execute our long-term strategy or otherwise adversely affect our future results of operations.

We have a Substantial Amount of Indebtedness, which could Impact our Ability to Obtain Future Financing or Pursue our Growth Strategy.

We have substantial indebtedness. As of December 31, 2014, our indebtedness principally consisted of a Term Loan of $229.1 million. In addition, we may incur additional amounts of debt under our existing credit facilities.

Our high level of indebtedness could have important consequences and significant adverse effects on our business, including the following:

- We must use a substantial portion of our cash flow from operations to pay interest and principal on our indebtedness, which will reduce the funds available to us for operations and other purposes;

- We must use a substantial portion of the proceeds of any asset sales to repay our indebtedness;

- Our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be limited;

- We are exposed to fluctuations in the interest rate environment because the interest rates under the Credit Facilities are variable;

- Our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate may be limited, which may place us at a competitive disadvantage compared to our competitors that have less debt;

- Our ability to pursue additional business opportunities may be limited; and

- Our high level of indebtedness may make us more vulnerable to economic downturns and adverse developments in our business.

The Credit Agreement contains, and the instruments governing any indebtedness we may incur in the future may contain, restrictive covenants that impose significant operating and financial restrictions, including restrictions on our ability to take actions that we believe may be in our best interest. The Credit Agreement, among other things, limits our ability to:

- Incur additional indebtedness and issue preferred stock;

- Create or incur liens;

- Enter into certain sale-leaseback transactions;
- Make certain investments or certain other restricted payments or make certain capital expenditures or acquisitions;
- Merge or consolidate without meeting certain conditions;
- Sell assets;
- Pay dividends on our capital stock or redeem, repurchase or retire our capital stock or indebtedness;
- Enter into transactions with our affiliates;
- Guarantee indebtedness;
- Issue or sell stock of certain subsidiaries.

Our failure to comply with these restrictive covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all or a portion of our outstanding indebtedness, which would have a material adverse effect on our business, financial condition and results of operations.

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Payments on our Indebtedness will Require a Significant Amount of Cash and our Ability to Service our Indebtedness is Impacted by Many Factors that are Outside of our Control.

We expect to obtain the funds to pay our expenses and to pay the amounts due under the Credit Agreement primarily from our operations. Our ability to meet our expenses and make these payments thus depends on our future performance, which will be affected by financial, business, economic and other factors, many of which we cannot control. Our business may not generate sufficient cash flow from operations in the future and our currently anticipated growth in revenue and cash flow may not be realized, either or both of which could result in our being unable to service our indebtedness, including the Credit Agreement, meet the financial covenants in the Credit Agreement or to fund other liquidity needs. If we do not have sufficient cash resources in the future, we may be required to refinance all or part of our then existing indebtedness, sell assets or borrow more money. We cannot be assured that we will be able to accomplish any of these alternatives on terms acceptable to us or at all. See the section captioned “Liquidity and Capital Resources” in the Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Annual Report on Form 10-K.

We may Incur Substantial Additional Indebtedness that could Further Exacerbate the Risks Associated with our Indebtedness.

We may incur substantial additional indebtedness in the future. Although the Credit Agreement contains restrictions on our incurrence of additional indebtedness, these restrictions are subject to a number of qualifications and exceptions, and we could incur substantial additional indebtedness in the future, including additional secured indebtedness. In addition, we may refinance our existing indebtedness, which would permit us to incur additional indebtedness. If we incur additional indebtedness, certain of the risks described above would intensify. Our ability to meet our cash requirements and service our indebtedness is impacted by many factors that are outside of our control.

Our Failure to Comply with the Credit Agreement, Including as a Result of Events Beyond our Control, Could Result in an Event of Default.

If there were an event of default under any of the agreements relating to the Credit Agreement, including as a result of our failure to meet the financial covenants included in the Credit Agreement with respect to our consolidated leverage ratio or our interest coverage ratio, we may not be able to incur additional indebtedness under the Credit Agreement and the holders of the defaulted debt could cause all amounts outstanding with respect to that debt to be due and payable immediately. We cannot assure you that our assets or cash flow would be sufficient to fully repay borrowings under our outstanding debt instruments if accelerated upon an event of default, which could have a material adverse effect on our ability to continue to operate as a going concern. Further, if we are unable to repay, refinance or restructure our secured debt, the holders of such debt could proceed against the collateral securing that indebtedness.

An Increase in Interest Rates Would Increase the Cost of Servicing our Debt and Could Reduce our Profitability.

The Credit Agreement provides that borrowings under the Credit Agreement bear interest at a variable rate. While we are able to mitigate the effects of interest rate changes pursuant to the Credit Agreement through the use of hedging transactions, we will not completely eliminate the effect of interest rate changes. As a result, interest rate changes will not affect our obligation for any debt incurred under the Credit Agreement, but could affect the amount of our interest payments, and accordingly, our future earnings and cash flows, assuming other factors are held constant. An increase in interest rates, whether because of an increase in market interest rates or an increase in our own cost of borrowing, would increase the cost of servicing our debt and could materially reduce our profitability.

We are required to pay regular dividends on the Series A Convertible Preferred Stock, par value $0.01 per share ("Preferred Stock") issued to investment funds (the “Series A Investors”) affiliated with Guggenheim Partners, LLC (“Guggenheim”), which ranks senior to our common stock, and we may be required under certain circumstances to repurchase the outstanding shares of Preferred Stock; such obligations could materially adversely affect our liquidity and financial condition.

The Preferred Stock ranks senior to our common stock with respect to dividend rights, and holders of Preferred Stock are entitled to cumulative dividends payable quarterly in cash at a rate of 8.5% per annum of the stated value of $1,000 per share. These regular cash dividends on our Preferred Stock are payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, commencing on March 31, 2015. In addition, the holders of our Preferred Stock have certain redemption rights, including upon certain change in control events involving us, which, if exercised, could require us to repurchase all of the outstanding shares of Preferred Stock at 100% or more of the stated value of the Preferred Stock, plus all accrued but unpaid dividends. These redemption rights include a right to force us to redeem the Preferred Stock at any time prior to August 25, 2015 for an amount equal to 100% of the stated value of the Preferred Stock, plus all accrued but unpaid dividends. If we are forced to redeem the Preferred Stock prior to August 25, 2015 and are unable to do so, the dividend rate on the Preferred Stock will increase at an additional rate of three percent for the first 180 days and an additional two percent for each additional 180 day period up to a maximum of fifteen and one half percent. In addition, the Credit Agreement places limitations on our ability to redeem the Preferred Stock using cash on hand and additional indebtedness, which may require us to issue additional shares of our common stock or preferred stock in order to fund such redemption.

Any required redemption of the outstanding shares of Preferred Stock could impact our liquidity and reduce the amount of cash flows available for working capital, capital expenditures, growth opportunities, acquisitions, and other general corporate purposes. Redemptions could also result in significant dilution of our outstanding common stock. Our obligations to the holders of Preferred Stock could also limit our ability to obtain additional financing or increase our borrowing costs, which could have an adverse effect on our financial condition.

The issuance of 50,000 shares of our Preferred Stock to investment funds to the Series A Investors reduces the relative voting power of holders of our common stock, may dilute the ownership of such holders, and may adversely affect the market price of our common stock.

On February 25, 2015, we issued 50,000 shares of Preferred Stock to investment funds affiliated with Guggenheim. The Series A Investors currently own all of the outstanding shares of Preferred Stock, and based on the number of shares of our common stock outstanding as of February 25, 2015, the Series A Investors collectively own Preferred Stock convertible into approximately 10.9% of our common stock (after giving effect to the conversion of the shares of Preferred Stock). As holders of our Preferred Stock are entitled to vote, on an as-converted basis, together with holders of our common stock as a single class on all matters submitted to a vote of our common stock holders, the issuance of the Preferred Stock to the Series A Investors has effectively reduced the relative voting power of the holders of our common stock.

In addition, conversion of the Preferred Stock to common stock will dilute the ownership interest of existing holders of our common stock, and any sales in the public market of the common stock issuable upon conversion of the Preferred Stock could adversely affect prevailing market prices of our common stock. We have granted the Series A Investors registration rights in respect of the shares of Preferred Stock and any shares of common stock issued upon conversion of the Preferred Stock. These registration rights would facilitate the resale of such securities into the public market, and any such resale would increase the number of shares of our common stock available for public trading. Sales by the Series A Investors of a substantial number of shares of our common stock in the public market, or the perception that such sales might occur, could have a material adverse effect on the price of our common stock.

The Series A Investors may exercise significant influence over us, including through their ability to elect one of the members of our Board of Directors.

As of February 25, 2015, the shares of Preferred Stock owned by the Series A Investors represent approximately 10.9% of the voting rights of our common stock, on an as-converted basis, so the Series A Investors will have the ability to significantly influence the outcome of any matter submitted for the vote of our stockholders. In addition, the Certificate of Designations of the Preferred Stock and the investor rights agreement entered into in connection therewith grant certain consent rights to the holders of Preferred Stock in respect of certain actions by us, including the issuance of pari passu or senior equity securities of the company, certain amendments to our certificate of incorporation or bylaws, any change in the size of our Board, the payment of certain distributions to our stockholders, and the incurrence of indebtedness that would have terms that are materially more restrictive than the Credit Agreement. The Series A Investors may have interests that diverge from, or even conflict with, those of our other stockholders. For example, Guggenheim and its affiliates may have an interest in directly or indirectly pursuing acquisitions, divestitures, financings or other transactions that, in their judgment, could enhance their other equity investments, even though such transactions might involve risks to us. Guggenheim and its affiliates are in the business of making or advising on investments in companies, including businesses that may directly or indirectly compete with certain portions of our business. They may also pursue acquisition opportunities that may be complementary to our business, and, as a result, those acquisition opportunities may not be available to us.

In addition, the purchase agreement entered into in connection with the issuance of the Preferred Stock (the “Purchase Agreement”) grants the Series A Investors certain rights to designate a director to serve on our Board. For so long as the Series A Investors and their permitted transferees beneficially own shares of Preferred Stock or the as-converted common stock purchased pursuant to the Purchase Agreement that represent more than 25% of the number of shares of the as-converted common stock purchased pursuant to the Purchase Agreement, the majority Series A Investors will have the right to designate for nomination one director to our Board. In addition, we agreed to submit to our stockholders at our next annual meeting a shareholder proposal pursuant to which the holders of Preferred Stock would be permitted to elect a director directly.

Our Performance Depends on our Ability to Attract and Retain Qualified Personnel.

We are dependent, in part, upon the services of our senior executives and other key business and technical personnel and competition for these types of highly skilled individuals is intense. We may not be able to retain existing key employees or be able to attract and retain skilled personnel on acceptable terms. We do not currently maintain key-man life insurance on our senior executives. If we are unable to fill any open positions with adequately qualified employees who are capable of quickly learning the responsibilities associated with their positions, or we fail to retain those employees, our business and financial results could be materially adversely affected.

Concerns About our Financial Stability Could Adversely Affect our Sales.

April 1, 2006

Net sales	$ 320,128	$ 296,447
Cost of goods sold	213,748	188,283

Gross profit

106,380

108,164

Selling, general, and administrative expenses

88,246

82,982

Closure costs

4,507

81

Royalty income

(7,545

)

(7,174

)

Operating income

21,172

32,275

Interest expense, net

5,728

6,884

Income before income taxes

15,444

25,391

Provision for income taxes

5,833

9,606

Net income

$

9,611

$

15,785

Basic net income per common share

$

0.16

$

0.27

Diluted net income per common share

$

0.16

$

0.26

Basic weighted-average number of shares outstanding

58,447,494

57,709,034

Diluted weighted-average number of shares outstanding

61,210,621

61,135,278

See accompanying notes to the unaudited condensed consolidated financial statements

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

	For the three-month periods ended March 31, 2007	April 1, 2006
Cash flows from operating activities:		
Net income	$ 9,611	$ 15,785
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,661	6,169
Amortization of debt issuance costs	292	468
Non-cash stock-based compensation expense	1,617	1,339
Income tax benefit from exercised stock options	(360)	(795)
Loss on sale of property, plant, and equipment	194	75
Deferred income taxes	(1,401)	5,691
Non-cash closure costs	2,414	
Effect of changes in operating assets and liabilities:		
Accounts receivable	(6,249)	(11,870)
Inventories	34,014	34,113
Prepaid expenses and other assets	(4,917)	(2,199)
Accounts payable and other liabilities	(37,199)	(62,739)
Net cash provided by (used in) operating activities	6,677	(13,963)
Cash flows from investing activities:		
Capital expenditures	(3,118)	(2,150)
Proceeds from sale of property, plant, and equipment		364
Net cash used in investing activities	(3,118)	(1,786)
Cash flows from financing activities:		
Payments on term loan	(876)	(10,080)
Share repurchase (Note 6)	(30,000)	
Income tax benefit from exercised stock options	360	795
Proceeds from exercise of stock options	162	420
Net cash used in financing activities	(30,354)	(8,865)
Net decrease in cash and cash equivalents	(26,795)	(24,614)
Cash and cash equivalents, beginning of period	68,545	84,276
Cash and cash equivalents, end of period	$ 41,750	$ 59,662

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		375			375
Exercise of stock options (48,792 shares)	1	161			162
Stock-based compensation expense		1,482			1,482
FIN 48 cumulative effect of adoption (Note 4)				2,588	2,588
Share repurchase (Note 6)	(12)	(29,988)			(30,000)
Comprehensive income (loss):					
Net income				9,611	9,611
Unrealized loss on interest rate swap, net of tax benefit of $235			(411)		(411)
Unrealized loss on interest rate collar, net of tax benefit of $36			(63)		(63)
Total comprehensive income (loss)			(474)	9,611	9,137
Balance at March 31, 2007	$ 578	$ 247,075	$ 4,827	$ 226,755	$ 479,235

See accompanying notes to the unaudited condensed consolidated financial statements.

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

NOTE 1 THE COMPANY:

Carter s, Inc. and its wholly owned subsidiaries (collectively, the Company, we, us, its, and our) design, source, and market branded childrenswear under the *Carter s*, *Child of Mine*, *Just One 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 March 31, 2007, the results of our operations for the three-month periods ended March 31, 2007 and April 1, 2006, cash flows for the three-month periods ended March 31, 2007 and April 1, 2006 and changes in stockholders equity for the three-month period ended March 31, 2007. Operating results for the three-month period ended March 31, 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 first quarter of fiscal 2007 reflect our financial position as of March 31, 2007. The first quarter of fiscal 2006 ended on April 1, 2006.

Certain prior year amounts have been reclassified for comparative purposes.

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 of March 31, 2007, cost in excess of fair value of net assets acquired and other intangible assets resulting from the Acquisition were as follows:

(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization
Cost in excess of fair value of net assets acquired	Indefinite	$ 143,186	$
OshKosh tradename	Indefinite	$ 102,000	$
OshKosh licensing agreements	4.7 years	$ 19,100	$ 7,269
Leasehold interests	4.1 years	$ 1,833	$ 798

Amortization expense for intangible assets was approximately $1.2 million for each of the three-month periods ended March 31, 2007 and April 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 April 1 through December 29)	$ 3,266
2008	4,106
2009	3,717
2010	1,777
Total	$ 12,866

As described in Note 2 Summary of Significant Accounting Policies to our audited consolidated financial statements 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 50 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 cost in excess of fair value of net assets acquired 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 $1.6 million of interest and penalties accrued as of March 31, 2007.

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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 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 March 31, 2007	April 1, 2006
Service cost benefits attributed to service during the period	$ 28	$ 42
Interest cost on accumulated post-retirement benefit obligation	137	158
Amortization of prior service cost	(9)	23
Total net periodic benefit cost	$ 156	$ 223

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

(dollars in thousands)	For the three-month periods ended March 31, 2007	April 1, 2006
Interest cost on accumulated pension benefit obligation	$ 15	$ 19

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

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

(dollars in thousands)	For the three-month periods ended March 31, 2007	April 1, 2006
Interest cost on accumulated pension benefit obligation	$ 551	$ 650
Expected return on assets	(912)	(1,035)
Amortization of actuarial gain	(35)	
Total net periodic pension benefit	$ (396)	$ (385)

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 Company s 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.

During the three-month period ended March 31, 2007, the Company repurchased and retired approximately $30 million, or 1,252,832 shares, of its common stock at an average price of $23.95 per share. 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.

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 three-month period ended March 31, 2007:

	For the three-month period ended March 31, 2007	
Volatility	38.42	%
Risk-free interest rate	4.69	%
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.

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The following table summarizes our stock option and restricted stock activity during the three-month period ended March 31, 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	131,600			67,400
Exercised	(48,792)			
Vested restricted stock				(18,400)
Forfeited	(16,000)			
Expired				
Outstanding, March 31, 2007	4,733,486	620,000	1,071,870	271,620
Exercisable, March 31, 2007	3,770,216		1,071,870	

During the three-month period ended March 31, 2007, we granted 131,600 time-based stock options with a Black-Scholes fair value of $10.06 and an exercise price of $22.19. In connection with this grant, we recognized approximately $38,000 in stock-based compensation expense during the three-month period ended March 31, 2007.

During the three-month period ended March 31, 2007, we granted 67,400 shares of restricted stock to employees with a fair value on the date of grant of $22.19. In connection with this grant, we recognized approximately $42,000 in stock-based compensation expense during the three-month period ended March 31, 2007.

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 April 1 through December 29)	$ 2,093	$ 1,149	$ 1,414	$ 4,656
2008	2,680	1,530	1,857	6,067
2009	1,587	741	1,403	3,731
2010	452	90	492	1,034
2011	42		47	89
Total	$ 6,854	$ 3,510	$ 5,213	$ 15,577

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 period ended March 31, 2007	% of Total	For the three-month period ended April 1, 2006	% of Total
Net sales:				
Wholesale-Carter s	$ 112,653	35.2 %	$ 102,361	34.5 %
Wholesale-OshKosh	24,993	7.8 %	28,680	9.7 %
Retail-Carter s	74,826	23.4 %	69,068	23.3 %
Retail-OshKosh	45,848	14.3 %	42,312	14.3 %
Mass Channel-Carter s	61,808	19.3 %	54,026	18.2 %
Total net sales	$ 320,128	100.0 %	$ 296,447	100.0 %

		% of segment net sales		% of segment net sales
Operating income (loss):				
Wholesale-Carter s	$ 21,386	19.0 %	$ 20,438	20.0 %
Wholesale-OshKosh	(687)	(2.7)%	3,353	11.7 %
Retail-Carter s	7,909	10.6 %	11,260	16.3 %
Retail-OshKosh	(1,293)	(2.8)%	230	0.5 %
Mass Channel-Carter s	8,351	13.5 %	8,177	15.1 %
Mass Channel-OshKosh (a)	527		130	
Segment operating income (loss)	36,193	11.3 %	43,588	14.7 %
Other reconciling items	(15,021)	(4.7)%	(11,313)	(3.8)%
Total operating income (loss)	$ 21,172	6.6 %	$ 32,275	10.9 %

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

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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. The Company recently determined that *OshKosh* brand products can 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 is 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 will be subject to accelerated depreciation over their remaining estimated useful life. Distribution operations at the White House facility are expected to cease by the end of April 2007.

For a majority of the affected employees, severance benefits were communicated on February 20, 2007. Approximately 215 employees will be terminated. In connection with this closure, we expect to incur approximately $4.5 million in cash expenses. These cash expenses consist of severance and other employee-related costs to exit the facility. The Company also expects to incur approximately $4.5 million of non-cash charges relating to accelerated depreciation and asset impairment.

During the first quarter of fiscal 2007, we recorded costs of $6.0 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, $1.5 million of accelerated depreciation (included in selling, general, and administrative expenses), and $0.1 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

The estimated value of the White House assets, subsequent to recording accelerated depreciation through the end of April 2007, is expected to be $6.2 million, at which time we anticipate the land, building, and equipment will be reclassified as held for sale.

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. We expect to pay these liabilities during fiscal 2007.

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

Sewing Facility Closures

In May 2005, we decided to exit two *Carter s* brand sewing facilities in Mexico. During the first quarter of fiscal 2006, we recorded total charges of $81,000, including $65,000 in severance charges and $16,000 in other exit costs related to these closures.

Restructuring reserves related to these closures are as follows and are included in other current liabilities on the accompanying unaudited condensed consolidated balance sheet:

(dollars in thousands)	Severance	Lease termination costs	Total
Balance at December 30, 2006	$ 178	$ 42	$ 220
Payments	(70)		(70)
Balance at March 31, 2007	$ 108	$ 42	$ 150

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.

For the three-month period ended March 31, 2007, anti-dilutive shares of 529,500 and performance-based stock options of 620,000, were excluded from the computations of diluted earnings per share and for the three-month period ended April 1, 2006, anti-dilutive shares of 362,400 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:

	For the three-month periods ended March 31, 2007	April 1, 2006
Net income	$ 9,611,000	$ 15,785,000
Weighted-average number of common and common equivalent shares outstanding:		
Basic number of common shares outstanding	58,447,494	57,709,034
Dilutive effect of unvested restricted stock	49,760	39,496
Dilutive effect of stock options	2,713,367	3,386,748
Diluted number of common and common equivalent shares outstanding	61,210,621	61,135,278
Basic net income per common share	$ 0.16	$ 0.27
Diluted net income per common share	$ 0.16	$ 0.26

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.

In connection with the Acquisition of OshKosh B Gosh, Inc. on July 14, 2005 (the Acquisition), we recorded cost in excess of fair value of net assets acquired of $143.2 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. Estimated future cash flows used in such 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 such assets.

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 first quarter of fiscal 2007 reflect our financial position as of March 31, 2007. The first quarter of fiscal 2006 ended on April 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 **March 31, 2007**		**April 1, 2006**	
Wholesale sales:				
Carter s	35.2	%	34.5	%
OshKosh	7.8		9.7	
Total wholesale sales	43.0		44.2	
Retail store sales:				
Carter s	23.4		23.3	
OshKosh	14.3		14.3	
Total retail store sales	37.7		37.6	
Mass channel sales	19.3		18.2	
Consolidated net sales	100.0		100.0	
Cost of goods sold	66.8		63.5	
Gross profit	33.2		36.5	
Selling, general, and administrative expenses	27.6		28.0	
Closure costs	1.4			
Royalty income	(2.4	)	(2.4	)
Operating income	6.6		10.9	
Interest expense, net	1.8		2.3	
Income before income taxes	4.8		8.6	
Provision for income taxes	1.8		3.3	
Net income	3.0	%	5.3	%
Number of retail stores at end of period:				
Carter s	220		199	
OshKosh	157		142	
Total	377		341	

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Three-month period ended March 31, 2007 compared to the three-month period ended April 1, 2006

CONSOLIDATED NET SALES

In the first quarter of fiscal 2007, consolidated net sales increased $23.7 million, or 8.0%, to $320.1 million. These increases reflect growth in all of our *Carter s* brand distribution channels and our OshKosh retail store segment.

(dollars in thousands)	**For the three-month periods ended March 31, 2007**	**% of Total**		**April 1, 2006**	**% of Total**	
Net sales:						
Wholesale-Carter s	$ 112,653	35.2	%	$ 102,361	34.5	%
Wholesale-OshKosh	24,993	7.8	%	28,680	9.7	%
Retail-Carter s	74,826	23.4	%	69,068	23.3	%
Retail-OshKosh	45,848	14.3	%	42,312	14.3	%
Mass Channel-Carter s	61,808	19.3	%	54,026	18.2	%
Total net sales	$ 320,128	100.0	%	$ 296,447	100.0	%

CARTER S WHOLESALE SALES

Carter s brand wholesale sales increased $10.3 million, or 10.1%, in the first quarter of fiscal 2007 to $112.7 million. Excluding off-price sales, *Carter s* brand wholesale sales increased $10.4 million, or 10.7%, to $107.0 million in the first quarter of fiscal 2007. The increase in *Carter s* brand wholesale sales, excluding off-price sales, was driven by a 14% increase in units shipped, partially offset by a 3% decline in average price per unit as compared to the first quarter of fiscal 2006.

The growth in units shipped during the first quarter of fiscal 2007 was driven by increases in all product categories due to increased demand. The decline in average price per unit was due primarily to lower average prices in our sleepwear product category. The average price per unit in our baby and playwear product categories was flat as compared to the first quarter of fiscal 2006.

Off-price sales decreased 1% as compared to the first quarter of fiscal 2006 due to a decrease in off-price units shipped.

OSHKOSH WHOLESALE SALES

OshKosh brand wholesale sales decreased $3.7 million, or 12.9%, in the first quarter of fiscal 2007 to $25.0 million. Excluding off-price sales, *OshKosh* brand wholesale sales decreased $2.1 million, or 7.9%, to $24.0 million in the first quarter of fiscal 2007. The decrease in *OshKosh* brand wholesale sales, excluding off-price sales, reflects reduced levels of demand for spring product.

Off-price sales decreased $1.6 million, or 63.3%, in the first quarter of fiscal 2007 to $0.9 million resulting from reduced levels of off-price inventory available for sale.

MASS CHANNEL SALES

Mass channel sales increased $7.8 million, or 14.4%, in the first quarter of fiscal 2007 to $61.8 million. The increase was driven by increased sales of $5.5 million, or 16.2%, of our *Child of Mine* brand to Wal-Mart and increased sales of $2.3 million, or 11.4%, of our *Just One Year* brand to Target. These increases in sales resulted primarily from increased productivity and new door growth.

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CARTER S RETAIL STORES

Carter s retail store sales increased $5.8 million, or 8.3%, in the first quarter of fiscal 2007 to $74.8 million. The increase was driven by incremental sales of $6.7 million generated by new store openings and a comparable store sales increase of $0.4 million, or 0.7%, partially offset by the impact of store closures of $1.4 million.

On a comparable store basis, average prices decreased 6.3% and units per transaction increased 4.5%. Average prices decreased primarily due to increased promotional pricing on spring playclothes and baby products. Increased promotional pricing drove the increase in units per transaction. Average inventory levels, on a comparable store basis, were down 11.0% as compared to the first quarter 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 220 Carter s retail stores as of March 31, 2007. During the first quarter of fiscal 2007, we opened one store. In total, we plan to open ten and close six Carter s retail stores during fiscal 2007.

OSHKOSH RETAIL STORES

OshKosh retail store sales increased $3.5 million, or 8.4%, in the first quarter of fiscal 2007 to $45.9 million. The increase was driven by incremental sales of $3.5 million generated by new store openings and a comparable store sales increase of $0.3 million, or 0.8%, partially offset by the impact of store closings of $0.3 million. On a comparable store basis, average prices decreased 0.3% and units per transaction decreased 0.5%. Average inventory levels, on a comparable store basis, were down 2.4% as compared to the first quarter of fiscal 2006.

There were a total of 157 OshKosh retail stores as of March 31, 2007. In total, we plan to open five and close three OshKosh retail stores during fiscal 2007.

GROSS PROFIT

Our gross profit decreased $1.8 million, or 1.6%, to $106.4 million in the first quarter of fiscal 2007. Gross profit as a percentage of net sales was 33.2% in the first quarter of fiscal 2007 as compared to 36.5% in the first quarter of fiscal 2006.

The decrease in gross profit as a percentage of net sales reflects:

(i) a decrease in gross profit in our consolidated retail business due to product upgrades and increased promotional pricing (gross profit dollars in our consolidated retail business decreased slightly despite an increase in consolidated retail net sales of 8.3%);

(ii) the impact of *OshKosh* brand wholesale spring product performance, which led to higher levels of customer accommodations in the first quarter of fiscal 2007; and

(iii) a decline in gross profit in our *Carter s* brand wholesale and mass channel businesses resulting from product upgrades.

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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 first quarter of fiscal 2007 increased $5.3 million, or 6.3%, to $88.2 million. As a percentage of net sales, selling, general, and administrative expenses in the first quarter of fiscal 2007 were 27.6% as compared to 28.0% in the first quarter of fiscal 2006.

The decrease in selling, general, and administrative expenses as a percentage of net sales was primarily a result of controlling growth in spending at a rate lower than the growth in net sales.

Partially offsetting this decrease was:

(i) growth in our retail store selling, general, and administrative expenses from 29.7% of retail store sales in the first quarter of fiscal 2006 to 30.8% of retail store sales in the first quarter of fiscal 2007 driven primarily by the higher cost structure and lower sales volume of our brand stores; and

(ii) accelerated depreciation charges of $1.5 million related to the closure of our White House, Tennessee distribution facility in the first quarter of fiscal 2007.

CLOSURE COSTS

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 is utilized to distribute the Company s *OshKosh* brand products. As a result of this closure, during the first quarter of fiscal 2007, we recorded costs of $6.0 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, $1.5 million of accelerated depreciation (included in selling, general, and administrative expenses), and $0.1 million of other closure costs.

In May 2005, we decided to exit two *Carter s* brand sewing facilities in Mexico. In the first quarter of fiscal 2006, in connection with these closures, we recorded costs of $81,000, including $65,000 of severance and $16,000 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 $7.5 million (including $1.7 million of international royalty income from our *OshKosh* brands) in the first quarter of fiscal 2007, an increase of 5.2%, or $0.4 million, as compared to the first quarter of fiscal 2006. This increase was driven primarily by increased sales of our *OshKosh* brand domestic licensees.

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OPERATING INCOME

Operating income decreased $11.1 million, or 34.4%, to $21.2 million in the first quarter of fiscal 2007. The decrease in operating income was due to the factors described above, including the costs incurred in the first quarter of fiscal 2007 related to the closure of our White House distribution facility.

INTEREST EXPENSE, NET

Interest expense in the first quarter of fiscal 2007 decreased $1.2 million, or 16.8%, to $5.7 million. The decrease is attributable to lower average borrowings in the first quarter of fiscal 2007, due to accelerated debt reduction, partially offset by a higher effective interest rate. Weighted-average borrowings in the first quarter of fiscal 2007 were $344.7 million at an effective interest rate of 7.20% as compared to weighted-average borrowings in the first quarter of fiscal 2006 of $426.7 million at an effective interest rate of 6.72%. In the first 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.

INCOME TAXES

Our effective tax rate was 37.8% for the first quarters of fiscal 2007 and 2006.

NET INCOME

Our net income for the first quarter of fiscal 2007 decreased $6.2 million, or 39.1%, to $9.6 million as compared to $15.8 million in the first quarter of fiscal 2006 as a result of the factors described above.

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 March 31, 2007 were $116.9 million compared to $108.0 million at April 1, 2006 and $110.6 million at December 30, 2006. The increase as compared to April 1, 2006 reflects an increase in *Carter s* brand wholesale sales in the latter part of the first quarter of fiscal 2007. Due to the seasonal nature of our operations, the net accounts receivable balance at March 31, 2007 is not comparable to the net accounts receivable balance at December 30, 2006.

Net inventories at March 31, 2007 were $159.6 million compared to $154.3 million at April 1, 2006 and $193.6 million at December 30, 2006. The increase of $5.3 million, or 3.4%, as compared to April 1, 2006 is due primarily to an increase in forecasted *Carter s* brand net sales offset by lower levels of excess inventory. Due to the seasonal nature of our operations, net inventories at March 31, 2007 are not comparable to net inventories at December 30, 2006.

Net cash provided by operating activities for the first quarter of fiscal 2007 was $6.7 million compared to net cash used in operating activities of $14.0 million in the first quarter of fiscal 2006. Net cash flow from operations in the first quarter of fiscal 2006 was impacted by significant reductions in accounts payable and accrued liabilities as a result of the payment of Acquisition-related liabilities, payment of increased levels of incentive compensation, and the timing of payments to vendors.

On February 16, 2007, the Company s 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 first quarter ended March 31, 2007, the Company repurchased and retired approximately $30 million, or 1,252,832 shares, of its common stock at an average price $23.95 per share.

As a result of the plan to close the White House, Tennessee distribution facility, we recorded costs in the first quarter of fiscal 2007 of $6.0 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, $1.5 million of accelerated depreciation (included in selling, general, and administrative expenses), and $0.1 million of other closure costs. Additional charges to be incurred during the remainder of fiscal 2007 are estimated to be $2.5 million and are comprised of severance charges, accelerated depreciation, and other exit costs. We expect to incur $0.5 million of additional charges in fiscal 2008, consisting primarily of other exit 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

The estimated value of the White House assets, subsequent to recording accelerated depreciation through the end of April 2007, is expected to be $6.2 million, at which time we anticipate the land, building, and equipment will be reclassified as held for sale.

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 in the accompanying unaudited condensed consolidated balance sheet, were established at the closing of the Acquisition and will be funded by cash flows from operations and borrowings under our revolver and are expected to be paid in fiscal 2007:

(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

We invested $3.1 million in capital expenditures during the first quarter of fiscal 2007 compared to $2.2 million during the first quarter of fiscal 2006. We plan to invest an additional $30 million to $33 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 three-month period ended March 31, 2007 were $344.7 million at an effective interest rate of 7.20% as compared to weighted-average borrowings of $426.7 million at an effective interest rate of 6.72% for the three-month period ended April 1, 2006.

At March 31, 2007, we had approximately $344.2 million in term loan borrowings and no borrowings outstanding under our revolver, exclusive of approximately $15.8 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 March 31, 2007, approximately $160.1 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 $600,000 in the first quarter of fiscal 2007 and $1,092,466 in the first quarter 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.

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Cost in excess of fair value of net assets acquired and tradename: As of March 31, 2007, we had approximately $602.0 million in cost in excess of fair value of net assets acquired and 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 was estimated at the Acquisition to be approximately $102.0 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. Our impairment review of cost in excess of fair value of net assets acquired is based on the estimated fair values of the underlying businesses. These estimated fair values are based on estimates of the future cash flows of the businesses.

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 Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123R). 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 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 March 31, 2007, our outstanding debt aggregated $344.2 million, of which $84.1 million bore interest at a variable rate. An increase of 1% in the applicable rate would increase our annual interest cost by $0.8 million, exclusive of variable rate debt subject to our swap and collar agreements, and could have an adverse effect on our net 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.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer of Carter s, Inc. 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 of Carter s, Inc. 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.

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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 first quarter of fiscal 2007, we derived approximately 47.0% of our consolidated net sales from our top eight customers, including mass channel customers. Wal-Mart and Kohl s accounted for approximately 12% and 9%, respectively, of our consolidated net sales. 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 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.

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

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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 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, 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 March 31, 2007, we had total debt of approximately $344.2 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 $143.2 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. Estimated future cash flows used in such 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 such assets.

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 SECURTIES AND USE OF PROCEEDS:

The following table provides information about purchases by the Company during the quarter ended March 31, 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)
December 31, 2006 through January 27, 2007			$		$
January 28, 2007 through February 24, 2007			$		$ 100,000,000
February 25, 2007 through March 31, 2007	1,252,832	(2)	$ 23.95	1,252,832	$ 69,999,877
Total	1,252,832		$ 23.95	1,252,832	$ 69,999,877

(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 $69,999,877 as of March 31, 2007.

(2) Represents repurchased shares which were retired.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES:

N/A

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

N/A

ITEM 5. OTHER INFORMATION:

N/A

ITEM 6. EXHIBITS:

(a) Exhibits:

Exhibit Number	**Description of Exhibits**
31.1	Rule 13a-15(e)/15d-15(e) and 13a-15(f)/15d-15(f) Certification
31.2	Rule 13a-15(e)/15d-15(e) and 13a-15(f)/15d-15(f) Certification
32	Section 1350 Certification

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

CARTER S, INC.

Date: May 10, 2007	/s/ FREDERICK J. ROWAN, II Frederick J. Rowan, II *Chairman of the Board of Directors and* *Chief Executive Officer*
Date: May 10, 2007	/s/ MICHAEL D. CASEY Michael D. Casey *Executive Vice President and* *Chief Financial Officer*

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