

CARTERS INC
Form 10-Q
July 24, 2014

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 28, 2014 OR

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

Commission file number:

001-31829

CARTER'S, INC.

(Exact name of Registrant as specified in its charter)

Delaware

13-3912933

(state or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

Phipps Tower

3438 Peachtree Road NE, Suite 1800

Atlanta, Georgia 30326

(Address of principal executive offices, including zip code)

(678) 791-1000

(Registrant's telephone number, including area code)

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

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

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

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

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

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

Common Stock

Outstanding Shares at July 18, 2014

Common stock, par value \$0.01 per share

53,142,916

CARTER'S, INC.
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PART 1 - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CARTER'S, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except for share data)
(unaudited)

| | June 28, 2014 | December 28, 2013 | June 29, 2013 |
|---|---------------|----------------------|---------------|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$207,920 | \$286,546 | \$312,132 |
| Accounts receivable, net | 133,885 | 193,611 | 133,277 |
| Finished goods inventories, net | 538,233 | 417,754 | 429,223 |
| Prepaid expenses and other current assets | 43,684 | 35,157 | 48,621 |
| Deferred income taxes | 36,534 | 37,313 | 32,948 |
| Total current assets | 960,256 | 970,381 | 956,201 |
| Property, plant, and equipment, net | 325,675 | 307,885 | 208,094 |
| Tradenames and other intangibles, net | 318,346 | 330,258 | 342,883 |
| Goodwill | 186,173 | 186,077 | 186,957 |
| Deferred debt issuance costs, net | 7,407 | 8,088 | 2,486 |
| Other assets | 11,305 | 9,795 | 5,130 |
| Total assets | \$1,809,162 | \$1,812,484 | \$1,701,751 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | \$164,199 | \$164,010 | \$199,588 |
| Other current liabilities | 75,561 | 105,129 | 74,062 |
| Total current liabilities | 239,760 | 269,139 | 273,650 |
| Long-term debt | 586,000 | 586,000 | 186,000 |
| Deferred income taxes | 114,878 | 121,434 | 112,171 |
| Other long-term liabilities | 148,152 | 135,180 | 108,993 |
| Total liabilities | \$1,088,790 | \$1,111,753 | \$680,814 |
| Commitments and contingencies | | | |
| Stockholders' equity: | | | |
| Preferred stock; par value \$.01 per share; 100,000 shares authorized; none issued or outstanding at June 28, 2014, December 28, 2013, and June 29, 2013 | — | — | — |
| Common stock, voting; par value \$.01 per share; 150,000,000 shares authorized; 53,311,864, 54,541,879 and 59,353,894 shares issued and outstanding at June 28, 2014, December 28, 2013 and June 29, 2013, respectively | 533 | 545 | 594 |
| Additional paid-in capital | — | 4,332 | 238,167 |
| Accumulated other comprehensive loss | (10,050) |) (10,082 |) (15,207 |
| Retained earnings | 729,889 | 705,936 | 797,383 |
| Total stockholders' equity | 720,372 | 700,731 | 1,020,937 |
| Total liabilities and stockholders' equity | \$1,809,162 | \$1,812,484 | \$1,701,751 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | Fiscal quarter ended | | Two fiscal quarters ended | |
|---|----------------------|------------------|---------------------------|------------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Net sales | \$574,065 | \$517,874 | \$1,225,709 | \$1,108,883 |
| Cost of goods sold | 328,588 | 297,629 | 718,507 | 645,576 |
| Gross profit | 245,477 | 220,245 | 507,202 | 463,307 |
| Selling, general, and administrative expenses | 206,315 | 195,014 | 416,410 | 380,375 |
| Royalty income | (8,185) | (7,507) | (18,086) | (16,749) |
| Operating income | 47,347 | 32,738 | 108,878 | 99,681 |
| Interest expense | 6,882 | 1,254 | 13,780 | 2,547 |
| Interest income | (140) | (194) | (272) | (384) |
| Other expense (income), net | (189) | 531 | 407 | 1,104 |
| Income before income taxes | 40,794 | 31,147 | 94,963 | 96,414 |
| Provision for income taxes | 14,897 | 11,474 | 34,770 | 35,326 |
| Net income | \$25,897 | \$19,673 | \$60,193 | \$61,088 |
| Basic net income per common share | \$0.48 | \$0.33 | \$1.12 | \$1.03 |
| Diluted net income per common share | \$0.48 | \$0.33 | \$1.11 | \$1.02 |
| Dividend declared and paid per common share | \$0.19 | \$0.16 | \$0.38 | \$0.16 |

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)

(unaudited)

| | Fiscal quarter ended | | Two fiscal quarters ended | |
|--|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Net income | \$25,897 | \$19,673 | \$60,193 | \$61,088 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 2,792 | (2,537) |) 32 | (4,002) |
| Comprehensive income | \$28,689 | \$17,136 | \$60,225 | \$57,086 |

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(amounts in thousands, except share amounts)

(unaudited)

| | Common stock - shares | Common stock - \$ | Additional paid-in capital | Accumulated other comprehensive (loss) income | Retained earnings | Total stockholders' equity |
|---|--------------------------|----------------------|----------------------------------|--|----------------------|----------------------------------|
| Balance at December 28, 2013 | 54,541,879 | \$545 | \$4,332 | \$(10,082) | \$705,936 | \$700,731 |
| Income tax benefit from stock-based compensation | — | — | 3,750 | — | — | 3,750 |
| Exercise of stock options | 213,926 | 1 | 6,547 | — | — | 6,548 |
| Withholdings from vesting of restricted stock | (62,645) |) | (4,251) |) | — | (4,251) |
| Restricted stock activity | 126,450 | 2 | (2) |) | — | — |
| Stock-based compensation expense | — | — | 8,748 | — | — | 8,748 |
| Issuance of common stock | 15,559 | — | 1,081 | — | — | 1,081 |
| Repurchase of common stock | (1,523,305) |) (15) |) (20,205) |) | (15,860) |) (36,080) |
| Cash dividends declared and paid | — | — | — | — | (20,380) |) (20,380) |
| Comprehensive income | — | — | — | 32 | 60,193 | 60,225 |
| Balance at June 28, 2014 | 53,311,864 | \$533 | \$— | \$(10,050) | \$729,889 | \$720,372 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | Two fiscal quarters ended | |
|---|---------------------------|------------------|
| | June 28, 2014 | June 29, 2013 |
| Cash flows from operating activities: | | |
| Net income | \$60,193 | \$61,088 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 29,679 | 24,936 |
| Amortization of H.W. Carter and Sons tradenames | 11,877 | 1,000 |
| Non-cash revaluation of contingent consideration | 451 | 1,866 |
| Amortization of debt issuance costs | 763 | 392 |
| Non-cash stock-based compensation expense | 9,829 | 8,425 |
| Income tax benefit from stock-based compensation | (3,750) | (9,929) |
| Loss on disposal of property, plant, and equipment | 544 | 112 |
| Deferred income taxes | (5,626) | 557 |
| Effect of changes in operating assets and liabilities: | | |
| Accounts receivable | 59,761 | 34,519 |
| Inventories | (120,383) | (81,361) |
| Prepaid expenses and other assets | (9,979) | (28,136) |
| Accounts payable and other liabilities | (235) | 56,371 |
| Net cash provided by operating activities | 33,124 | 69,840 |
| Cash flows from investing activities: | | |
| Capital expenditures | (61,300) | (70,566) |
| Acquisitions | — | (38,007) |
| Proceeds from sale of property, plant, and equipment | 134 | — |
| Net cash used in investing activities | (61,166) | (108,573) |
| Cash flows from financing activities: | | |
| Payments of debt issuance costs | (114) | — |
| Repurchase of common stock | (36,080) | (37,757) |
| Dividends paid | (20,380) | (9,522) |
| Income tax benefit from stock-based compensation | 3,750 | 9,929 |
| Withholdings from vesting of restricted stock | (4,251) | (4,539) |
| Proceeds from exercise of stock options | 6,548 | 11,210 |
| Net cash used in financing activities | (50,527) | (30,679) |
| Effect of exchange rate changes on cash | (57) | (692) |
| Net decrease in cash and cash equivalents | (78,626) | (70,104) |
| Cash and cash equivalents, beginning of period | 286,546 | 382,236 |
| Cash and cash equivalents, end of period | \$207,920 | \$312,132 |

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

NOTE 1 – THE COMPANY

Carter's, Inc. and its wholly owned subsidiaries (collectively, the "Company" and "its") design, source, and market branded childrenswear under the Carter's, Child of Mine, Just One You, Precious Firsts, OshKosh, and other brands. The Company's products are sourced through contractual arrangements with manufacturers worldwide for wholesale distribution to major domestic and international retailers and for the Company's own retail stores and websites that market its brand name merchandise and other licensed products manufactured by other companies. As of June 28, 2014, the Company operated 509 Carter's stores in the United States, 187 OshKosh stores in the United States, and 110 stores in Canada.

NOTE 2 – BASIS OF PREPARATION

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

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all normal and recurring adjustments necessary to state fairly the consolidated financial condition, results of operations, comprehensive income, statement of stockholder's equity, and cash flows of the Company for the interim periods presented. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the fiscal quarter ended June 28, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending January 3, 2015.

The accompanying condensed consolidated balance sheet as of December 28, 2013 is derived from the Company's audited consolidated financial statements included in its most recently filed Annual Report on Form 10-K. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC and the instructions to Form 10-Q. The accounting policies the Company follows are set forth in the Annual Report on Form 10-K for the fiscal year ended December 28, 2013.

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

The Company's fiscal year ends on the Saturday, in December or January, nearest the last day of December, resulting in an additional week of results every five or six years. As a result, fiscal 2014, ending on January 3, 2015 will be comprised of 53 weeks.

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE LOSS

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

| (dollars in thousands) | June 28, 2014 | December 28, 2013 | June 29, 2013 |
|---|---------------|-------------------|---------------|
| Cumulative foreign currency translation adjustments | \$ (7,520 |) \$ (7,552 |) \$ (6,068 |
| Pension and post-retirement liability adjustment | (2,530 |) (2,530 |) (9,139 |
| | \$ (10,050 |) \$ (10,082 |) \$ (15,207 |

Total accumulated other comprehensive income
(loss)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 4 – GOODWILL AND OTHER INTANGIBLE ASSETS

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

| (dollars in thousands) | Weighted-average useful life | June 28, 2014 | | | December 28, 2013 | | |
|---|------------------------------|---------------|--------------------------|------------|-------------------|--------------------------|------------|
| | | Gross amount | Accumulated amortization | Net amount | Gross amount | Accumulated amortization | Net amount |
| Carter's goodwill | Indefinite | \$ 136,570 | \$— | \$ 136,570 | \$ 136,570 | \$— | \$ 136,570 |
| Bonnie Togs goodwill | Indefinite | 49,603 | — | 49,603 | 49,507 | — | 49,507 |
| Total goodwill | | \$ 186,173 | \$— | \$ 186,173 | \$ 186,077 | \$— | \$ 186,077 |
| Carter's tradename | Indefinite | \$ 220,233 | \$— | \$ 220,233 | \$ 220,233 | \$— | \$ 220,233 |
| OshKosh tradename | Indefinite | 85,500 | — | 85,500 | 85,500 | — | 85,500 |
| Other tradenames | 3 years | 38,007 | 25,465 | 12,542 | 38,007 | 13,588 | 24,419 |
| Bonnie Togs tradename | 2 years | 563 | 563 | — | 562 | 562 | — |
| Total tradenames | | 344,303 | 26,028 | 318,275 | 344,302 | 14,150 | 330,152 |
| Non-compete agreements | 4 years | 281 | 210 | 71 | 280 | 174 | 106 |
| Total tradenames and other intangibles, net | | \$ 344,584 | \$ 26,238 | \$ 318,346 | \$ 344,582 | \$ 14,324 | \$ 330,258 |

| (dollars in thousands) | Weighted-average useful life | June 29, 2013 | | |
|---|------------------------------|---------------|--------------------------|------------|
| | | Gross amount | Accumulated amortization | Net amount |
| Carter's goodwill | Indefinite | \$ 136,570 | \$— | \$ 136,570 |
| Bonnie Togs goodwill | Indefinite | 50,387 | — | 50,387 |
| Total goodwill | | \$ 186,957 | \$— | \$ 186,957 |
| Carter's tradename | Indefinite | \$ 220,233 | \$— | \$ 220,233 |
| OshKosh tradename | Indefinite | 85,500 | — | 85,500 |
| Other tradenames | 3 years | 38,007 | 1,000 | 37,007 |
| Bonnie Togs tradename | 2 years | 572 | 572 | — |
| Total tradenames | | 344,312 | 1,572 | 342,740 |
| Non-compete agreements | 4 years | 285 | 142 | 143 |
| Total tradenames and other intangibles, net | | \$ 344,597 | \$ 1,714 | \$ 342,883 |

The Company recorded approximately \$5.6 million and \$11.9 million of amortization expense for the fiscal quarter and two fiscal quarters ended June 28, 2014. The Company recorded approximately \$1.1 million of amortization expense for the fiscal quarter and two fiscal quarters ended June 29, 2013. The estimated future amortization expense for these assets is approximately \$4.6 million for the remainder of fiscal 2014, \$6.2 million for fiscal 2015, and \$1.8 million for fiscal 2016.

NOTE 5 – COMMON STOCK:

Pursuant to the previously announced share repurchase authorizations by the Board of Directors, during the fiscal quarter and two fiscal quarters ended June 28, 2014, the Company repurchased and retired shares in open market transactions in the following amounts:

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

| | Fiscal quarter ended | | Two fiscal quarters ended | |
|--|----------------------|------------------|---------------------------|------------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Number of shares repurchased | 477,551 | 433,402 | 499,151 | 590,002 |
| Aggregate cost of shares repurchased (in millions) | \$ 34.4 | \$ 28.8 | \$ 36.1 | \$ 37.8 |
| Avg price per share | \$ 72.10 | \$ 66.49 | \$ 72.28 | \$ 63.99 |

The total remaining capacity under the repurchase authorizations as of June 28, 2014 was approximately \$231.2 million. The authorizations have no expiration date.

Accelerated Stock Repurchase Program

On August 29, 2013, the Company entered into two fixed dollar accelerated stock repurchase (ASR) agreements which were settled during January 2014 with approximately one million additional shares received by the Company with a fair market value, at trade date, of approximately \$70.3 million. Under the ASR agreements, the Company had received and retired a total of approximately 5.6 million shares.

NOTE 6 – LONG-TERM DEBT

Long-term debt consisted of the following:

| (dollars in thousands) | June 28, 2014 | December 28, 2013 | June 29, 2013 |
|-----------------------------------|------------------|----------------------|------------------|
| Senior notes | \$ 400,000 | \$ 400,000 | \$ — |
| Secured revolving credit facility | 186,000 | 186,000 | 186,000 |
| Total long-term debt | \$ 586,000 | \$ 586,000 | \$ 186,000 |

As of June 28, 2014, the Company had approximately \$186.0 million in borrowings under its secured revolving credit facility, exclusive of \$8.0 million of outstanding letters of credit. Amounts outstanding under the revolving credit facility currently accrue interest at a LIBOR rate plus 2.00%, which, as of June 28, 2014, was 2.15%. As of June 28, 2014, there was approximately \$181.0 million available for future borrowing. As of June 28, 2014, The William Carter Company ("TWCC"), a 100% owned subsidiary of Carter's Inc. had outstanding \$400 million principal amount of senior notes, bearing interest at a rate of 5.25% per annum, and maturing on August 15, 2021. The senior notes are unsecured and are fully and unconditionally guaranteed by Carter's, Inc. and certain subsidiaries of TWCC.

As of June 28, 2014 the Company was in compliance with the financial debt covenants under the secured revolving credit facility.

NOTE 7 – STOCK-BASED COMPENSATION

The Company recorded stock-based compensation cost as follows:

| (dollars in thousands) | Fiscal quarter ended | | Two fiscal quarters ended | |
|------------------------|----------------------|------------------|---------------------------|------------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Stock options | \$ 1,089 | \$ 1,233 | \$ 2,459 | \$ 2,508 |
| Restricted stock: | | | | |
| Time-based awards | 1,697 | 1,791 | 3,639 | 3,482 |

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| | | | | |
|--------------------------|----------|----------|----------|----------|
| Performance-based awards | 1,427 | 1,156 | 2,650 | 1,982 |
| Stock awards | 1,081 | 180 | 1,081 | 453 |
| Total | \$ 5,294 | \$ 4,360 | \$ 9,829 | \$ 8,425 |

All of the cost of stock-based compensation was reflected as a component of selling, general, and administrative expenses.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

STOCK OPTIONS

The following table summarizes the Company's stock option activity for the two fiscal quarters ended June 28, 2014:

| | Number of shares | Weighted- average exercise price | Weighted-average remaining contractual terms (years) | Aggregate intrinsic value (in thousands) |
|--|---------------------|--|---|--|
| Outstanding, December 28, 2013 | 1,677,741 | \$ 35.37 | | |
| Granted | 226,700 | 68.61 | | |
| Exercised | (213,926) |) 30.61 | | |
| Forfeited | (63,408) |) 47.35 | | |
| Expired | — | — | | |
| Outstanding, June 28, 2014 | 1,627,107 | \$ 40.16 | 6.91 | \$ 46,914 |
| Vested and Expected to Vest, June 28, 2014 | 1,555,647 | \$ 39.45 | 6.85 | \$ 45,926 |
| Exercisable, June 28, 2014 | 923,652 | \$ 28.82 | 5.67 | \$ 37,081 |

The intrinsic value of stock options exercised during the two fiscal quarters ended June 28, 2014 and June 29, 2013 was approximately \$9.6 million and \$27.2 million, respectively. At June 28, 2014, there was approximately \$9.7 million of unrecognized compensation cost (net of estimated forfeitures) related to stock options which is expected to be recognized over a weighted-average period of approximately 2.8 years.

The table below presents the assumptions used to calculate the fair value of options granted:

| | Two fiscal quarters ended | | |
|--|---------------------------|------------------|---|
| | June 28, 2014 | June 29, 2013 | |
| Expected volatility | 30.86 | % 33.17 | % |
| Risk-free interest rate | 1.82 | % 1.12 | % |
| Expected term (years) | 6.0 | 6.0 | |
| Dividend yield | 1.11 | % — | % |
| Weighted average fair value of options granted | \$ 19.83 | \$ 20.15 | |

RESTRICTED STOCK AWARDS

The following table summarizes activity related to all restricted stock awards during the two fiscal quarters ended June 28, 2014:

| | Restricted stock awards | Weighted-average grant-date fair value |
|--------------------------------|-------------------------------|--|
| Outstanding, December 28, 2013 | 786,189 | \$ 44.87 |
| Granted | 189,109 | \$ 68.89 |
| Vested restricted stock | (172,609) |) \$ 42.45 |
| Forfeited | (51,458) |) \$ 46.84 |
| Outstanding, June 28, 2014 | 751,231 | \$ 51.34 |

Time-based Restricted Stock Awards

At June 28, 2014, there was approximately \$15.2 million of unrecognized compensation cost (net of estimated forfeitures) related to restricted stock which is expected to be recognized over a weighted-average period of approximately 2.8 years.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Performance-based Restricted Stock Awards

During the first fiscal quarter of 2014, the Company granted its executive officers 61,200 performance restricted shares at a fair market value of \$68.49 per share. During the first fiscal quarter of 2013, the Company granted its executive officers an aggregate of 118,200 performance-based restricted shares at a fair market value of \$59.27 per share.

Vesting of the performance restricted shares granted in the first quarter of fiscal 2014 and 2013 is contingent upon meeting specific performance targets through 2015 (in the case of the fiscal 2013 awards) and 2016 (in the case of the fiscal 2014 awards). Currently, the Company believes that the respective targets will be achieved and has recorded compensation expense based on the proration of the total ultimate expected value of the award.

At June 28, 2014, there was approximately \$8.5 million of unrecognized compensation cost (net of estimated forfeitures) related to performance-based restricted stock awards which is expected to be recognized over a weighted-average period of approximately 1.9 years.

NOTE 8 – EMPLOYEE BENEFIT PLANS

OSHKOSH B'GOSH PENSION PLAN

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

| (dollars in thousands) | Fiscal quarter ended | | Two fiscal quarters ended | |
|-------------------------------------|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Interest cost | \$622 | \$584 | \$1,244 | \$1,168 |
| Expected return on plan assets | (798) | (764) | (1,596) | (1,528) |
| Recognized actuarial loss | 21 | 207 | 42 | 414 |
| Net periodic pension (benefit) cost | \$(155) | \$27 | \$(310) | \$54 |

POST-RETIREMENT LIFE AND MEDICAL PLAN

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

| (dollars in thousands) | Fiscal quarter ended | | Two fiscal quarters ended | |
|---|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Service cost – benefits attributed to service during the period | \$28 | \$40 | \$56 | \$80 |
| Interest cost on accumulated post-retirement benefit obligation | 57 | 58 | 114 | 116 |
| Amortization net actuarial gain | (52) | (34) | (104) | (68) |
| Curtailment gain | (22) | — | (44) | — |
| Total net periodic post-retirement benefit cost | \$11 | \$64 | \$22 | \$128 |

NOTE 9 – INCOME TAXES

As of June 28, 2014, the Company had gross unrecognized tax benefits of approximately \$11.8 million, of which \$8.4 million, if ultimately recognized, will affect the Company's effective tax rate in the period settled. The Company has recorded tax positions for which the ultimate deductibility is more likely than not, but for which there is uncertainty

about the timing of such deductions. Because of deferred tax accounting, changes in the timing of these deductions would not affect the annual effective tax rate, but could accelerate the payment of cash to the taxing authorities.

Included in the reserves for unrecognized tax benefits are approximately \$1.7 million of reserves for which the statute of limitations is expected to expire within the next fiscal year. If these tax benefits are ultimately recognized, such recognition, net

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

of federal income taxes, may affect the annual effective tax rate for fiscal 2014 or fiscal 2015 and the effective tax rate in the quarter in which the benefits are recognized.

The Company recognizes interest related to unrecognized tax benefits as a component of interest expense and penalties related to unrecognized tax benefits as a component of income tax expense. During the fiscal quarter and two fiscal quarters ended June 28, 2014 and June 29, 2013, interest expense recorded on uncertain tax positions was not significant. The Company had approximately \$0.9 million, \$0.8 million, and \$0.8 million of interest accrued on uncertain tax positions as of June 28, 2014, December 28, 2013, and June 29, 2013, respectively.

NOTE 10 – FAIR VALUE MEASUREMENTS

INVESTMENTS

The Company invests in marketable securities, principally equity-based mutual funds, to mitigate the risk associated with the investment return on employee deferrals of compensation. The Company had approximately \$6.7 million, \$5.4 million, and \$4.5 million of such Level 1 investments as of June 28, 2014, December 28, 2013, and June 29, 2013, respectively.

During the fiscal quarter and two fiscal quarters ended June 28, 2014 and June 29, 2013, gains on the investments in marketable securities were not significant.

CONTINGENT CONSIDERATION

The following table summarizes the changes in the contingent consideration liability related to the Company's acquisition of Bonnie Togs on June 30, 2011:

| (dollars in thousands) | Fiscal quarter ended | | Two fiscal quarters ended | | |
|---|----------------------|---------------|---------------------------|---------------|---|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 | |
| Balance at the beginning of period | \$16,315 | \$30,021 | 16,348 | 29,704 | |
| Payments made | — | — | — | — | |
| Accretion (income) expense | (8 |) 979 | 451 | 1,866 | |
| Foreign currency translation adjustment | 541 | (1,050 |) 49 | (1,620 |) |
| Balance at the end of period | \$16,848 | \$29,950 | \$16,848 | \$29,950 | |

The contingent consideration liability is a Level 3 fair value measurement. As of June 28, 2014, the Company determined the fair value of contingent consideration based upon a probability-weighted discounted cash flow analysis, reflecting a high probability that the earnings targets will be met and a discount rate of 18%.

BORROWINGS

As of June 28, 2014, the Level 2 fair value of the Company's \$186 million in borrowings under its secured revolving credit facility approximated carrying value. The Level 2 fair value of the Company's \$400 million in senior notes outstanding was approximately \$418.0 million.

NOTE 11 – EARNINGS PER SHARE

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

| | Fiscal quarter ended | | Two fiscal quarters ended | |
|---|----------------------|------------------|---------------------------|------------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Weighted-average number of common and common equivalent shares outstanding: | | | | |
| Basic number of common shares outstanding | 52,836,070 | 58,567,558 | 53,004,264 | 58,519,286 |
| Dilutive effect of equity awards | 455,116 | 588,622 | 478,426 | 648,072 |
| Diluted number of common and common equivalent shares outstanding | 53,291,186 | 59,156,180 | 53,482,690 | 59,167,358 |
| Basic net income per common share (in thousands, except per share data): | | | | |
| Net income | \$25,897 | \$19,673 | \$60,193 | \$61,088 |
| Income allocated to participating securities (345) | | (265) | (812) | (811) |
| Net income available to common shareholders | \$25,552 | \$19,408 | \$59,381 | \$60,277 |
| Basic net income per common share | \$0.48 | \$0.33 | \$1.12 | \$1.03 |
| Diluted net income per common share: | | | | |
| Net income | \$25,897 | \$19,673 | \$60,193 | \$61,088 |
| Income allocated to participating securities (343) | | (263) | (807) | (803) |
| Net income available to common shareholders | \$25,554 | \$19,410 | \$59,386 | \$60,285 |
| Diluted net income per common share | \$0.48 | \$0.33 | \$1.11 | \$1.02 |
| Anti-dilutive shares excluded from dilutive earnings per share computation | 268,850 | 350,200 | 268,850 | 362,500 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – OTHER CURRENT AND LONG-TERM LIABILITIES

Other current liabilities consisted of the following:

| (dollars in thousands) | June 28, 2014 | December 28, 2013 | June 29, 2013 |
|--|------------------|----------------------|------------------|
| Accrued bonuses and incentive compensation | \$6,320 | \$19,579 | \$8,008 |
| Contingent consideration | 9,360 | 8,964 | 14,262 |
| Accrued workers' compensation | 7,458 | 7,236 | 6,163 |
| Accrued sales and use taxes | 4,961 | 8,486 | 4,113 |
| Accrued salaries and wages | 5,744 | 7,609 | 6,049 |
| Accrued gift certificates | 8,422 | 7,899 | 6,315 |
| Accrued 401(k) contributions | 2,026 | 8,775 | 3,325 |
| Accrued closure costs | 3,487 | 9,128 | 9,264 |
| Other current liabilities | 27,783 | 27,453 | 16,563 |
| Total | \$75,561 | \$105,129 | \$74,062 |

Other long-term liabilities consisted of the following:

| (dollars in thousands) | June 28, 2014 | December 28, 2013 | June 29, 2013 |
|------------------------------|------------------|----------------------|------------------|
| Deferred lease incentives | \$71,821 | \$68,876 | \$33,335 |
| Accrued rent | 39,534 | 31,821 | 22,878 |
| Contingent consideration | 7,488 | 7,384 | 15,688 |
| OshKosh pension plan | 3,458 | 3,768 | 13,611 |
| Unrecognized tax benefits | 12,756 | 11,947 | 11,421 |
| Post-retirement medical plan | 5,122 | 5,055 | 6,329 |
| Deferred compensation | 7,869 | 6,225 | 5,699 |
| Other | 104 | 104 | 32 |
| Total | \$148,152 | \$135,180 | \$108,993 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – SEGMENT INFORMATION

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

| (dollars in thousands) | Fiscal quarter ended | | | | Two fiscal quarters ended | | | | |
|--------------------------------|----------------------|------------------------|---------------|------------------------|---------------------------|------------------------|---------------|------------------------|---|
| | June 28, 2014 | % of Total | June 29, 2013 | % of Total | June 28, 2014 | % of Total | June 29, 2013 | % of Total | |
| Net sales: | | | | | | | | | |
| Carter's Wholesale | \$200,059 | 34.8 | % \$196,734 | 38.0 | % \$471,688 | 38.5 | % \$444,912 | 40.1 | % |
| Carter's Retail (a) | 233,690 | 40.7 | % 199,370 | 38.5 | % 464,018 | 37.9 | % 407,799 | 36.8 | % |
| Total Carter's | 433,749 | 75.5 | % 396,104 | 76.5 | % 935,706 | 76.4 | % 852,711 | 76.9 | % |
| OshKosh Retail (a) | 67,515 | 11.8 | % 56,423 | 10.9 | % 131,073 | 10.7 | % 111,768 | 10.1 | % |
| OshKosh Wholesale | 11,649 | 2.0 | % 11,301 | 2.2 | % 27,235 | 2.2 | % 29,487 | 2.7 | % |
| Total OshKosh | 79,164 | 13.8 | % 67,724 | 13.1 | % 158,308 | 12.9 | % 141,255 | 12.8 | % |
| International (b) | 61,152 | 10.7 | % 54,046 | 10.4 | % 131,695 | 10.7 | % 114,917 | 10.3 | % |
| Total net sales | \$574,065 | 100.0 | % \$517,874 | 100.0 | % \$1,225,709 | 100.0 | % \$1,108,883 | 100.0 | % |
| Operating income: | | | | | | | | | |
| | | % of segment net sales | | % of segment net sales | | % of segment net sales | | % of segment net sales | |
| Carter's Wholesale | \$30,860 | 15.4 | % \$31,298 | 15.9 | % \$77,727 | 16.5 | % \$81,482 | 18.3 | % |
| Carter's Retail (a) | 40,179 | 17.2 | % 33,256 | 16.7 | % 83,158 | 17.9 | % 73,040 | 17.9 | % |
| Total Carter's | 71,039 | 16.4 | % 64,554 | 16.3 | % 160,885 | 17.2 | % 154,522 | 18.1 | % |
| OshKosh Retail (a) | (1,694) | (2.5) | % (6,073) | (10.8) | % (6,183) | (4.7) | % (11,168) | (10.0) | % |
| OshKosh Wholesale | 859 | 7.4 | % 681 | 6.0 | % 2,885 | 10.6 | % 3,484 | 11.8 | % |
| Total OshKosh | (835) | (1.1) | % (5,392) | (8.0) | % (3,298) | (2.1) | % (7,684) | (5.4) | % |
| International (b) | 7,107 | 11.6 | % 7,353 | 13.6 | % 11,143 | 8.5 | % 12,349 | 10.7 | % |
| Total segment operating income | 77,311 | 13.5 | % 66,515 | 12.8 | % 168,730 | 13.8 | % 159,187 | 14.4 | % |
| Corporate expenses (d) (e) | (29,964) | (5.2) | % (33,777) | (6.5) | % (59,852) | (4.9) | % (59,506) | (5.4) | % |
| Total operating income | \$47,347 | 8.2 | % \$32,738 | 6.3 | % \$108,878 | 8.9 | % \$99,681 | 9.0 | % |

(a) Includes eCommerce results.

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

(c) Includes the following charges:

| (dollars in millions) | Fiscal quarter ended | | Two fiscal quarters ended | |
|---|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Revaluation of contingent consideration | \$— | \$1.0 | \$0.5 | \$1.9 |
| Exit from Japan retail operations | \$0.9 | \$— | \$0.5 | \$— |

Corporate expenses include expenses related to incentive compensation, stock-based compensation, executive (d) management, severance and relocation, finance, building occupancy, information technology, certain legal fees, consulting, and audit fees.

(e) Includes the following charges:

| (dollars in millions) | Fiscal quarter ended | | Two fiscal quarters ended | |
|---|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Closure of distribution facility in Hogansville, GA (1) | \$0.3 | \$— | \$0.6 | \$0.6 |
| Office consolidation costs | \$4.6 | \$10.2 | \$6.6 | \$18.2 |
| Amortization of H.W. Carter and Sons tradenames | \$5.6 | \$1.0 | \$11.9 | \$1.0 |

(1) Continuing operating costs associated with the closure of the Company's distribution facility in Hogansville, Georgia.

NOTE 14 – FACILITY CLOSURE

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

HOGANSVILLE DISTRIBUTION FACILITY

In connection with the plan to close the Hogansville, Georgia distribution facility, the Company recorded the following charges in selling, general, and administrative expenses:

| (dollars in millions) | Fiscal quarter ended | | Two fiscal quarters ended | |
|--------------------------|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Severance | \$— | \$(0.2 |) \$— | \$0.3 |
| Accelerated depreciation | — | 0.1 | — | 0.3 |
| Total | \$— | \$— | \$— | \$0.6 |

The following table summarizes the restructuring reserves related to the closure of the Hogansville facility which are included in other current liabilities in the accompanying unaudited condensed consolidated balance sheet as of June 28, 2014:

| (dollars in millions) | Severance | Other closure costs | Total |
|------------------------------|-----------|---------------------|--------|
| Balance at December 28, 2013 | \$1.2 | \$0.1 | \$1.3 |
| Provision | — | — | — |
| Payments | (1.2 |) (0.1 |) (1.3 |
| Balance at June 28, 2014 | \$— | \$— | \$— |

As of June 29, 2013, restructuring reserves were approximately \$2.3 million. The salvage value of this facility is estimated to be \$2.0 million and is held for sale as of June 28, 2014.

OFFICE CONSOLIDATION

In connection with the Company's plan to consolidate into a new headquarters facility in Atlanta, Georgia, the Company recorded the following charges in selling, general, and administrative expenses:

| (dollars in millions) | Fiscal quarter ended | | Two fiscal quarters ended | |
|------------------------------|----------------------|---------------|---------------------------|---------------|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 |
| Other closure costs | \$4.3 | \$6.2 | \$5.7 | \$11.2 |
| Severance and other benefits | 0.3 | 2.7 | 0.9 | 4.5 |
| Accelerated depreciation | — | 1.3 | — | 2.5 |
| Total | \$4.6 | \$10.2 | \$6.6 | \$18.2 |

The following table summarizes the restructuring reserves related to the office consolidation as of June 28, 2014:

| (dollars in thousands) | Severance | Other closure costs | Total |
|------------------------------|-----------|---------------------|--------|
| Balance at December 28, 2013 | \$4.7 | \$1.7 | \$6.4 |
| Provision | 0.9 | 5.7 | 6.6 |
| Payments | (2.9 |) (4.7 |) (7.6 |
| Other | \$— | \$0.5 | \$0.5 |
| Balance at June 28, 2014 | \$2.7 | \$3.2 | \$5.9 |

The severance reserve is included in other current liabilities and other closure costs are included in other long-term liabilities in the accompanying unaudited condensed consolidated balance sheet.

As of June 29, 2013, restructuring reserves were approximately \$7.0 million.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company has substantially completed its consolidation efforts as of December 28, 2013, and the severance accrual is expected to be substantially paid by the end of fiscal 2014. The Company expects to incur approximately \$0.5 million in additional costs in fiscal 2014 in connection with the office consolidation.

JAPAN RETAIL OPERATIONS

In the fourth quarter of 2013, the Company made the decision to exit retail operations in Japan based on revised forecasts which do not meet the Company's investment objectives. The Company recorded the following charges in selling, general, and administrative expenses:

| | Fiscal quarter ended June 28, 2014 | Two fiscal quarters ended June 28, 2014 |
|------------------------------|---------------------------------------|--|
| (dollars in millions) | | |
| Other closure costs | \$0.4 | \$(0.3) |
| Severance and other benefits | 0.2 | 0.9 |
| Accelerated depreciation | 0.3 | 0.9 |
| Total | \$0.9 | \$1.5 |

The Company also recorded approximately \$1.0 million in cost of goods sold related to a favorable recovery on inventory in the two fiscal quarters ended June 28, 2014.

There were no such exit costs related to Japan recorded in the fiscal quarter and two fiscal quarters ended June 29, 2013.

The following table summarizes the restructuring reserves related to the exit of retail operations in Japan, which are included in other current liabilities in the accompanying unaudited condensed consolidated balance sheet as of June 28, 2014:

| (dollars in millions) | Severance | Other closure costs | Total |
|------------------------------|-----------|---------------------|---------|
| Balance at December 28, 2013 | \$0.9 | \$2.0 | \$2.9 |
| Provision | 0.9 | (0.3) |) 0.6 |
| Payments | (1.2) |) (1.7) |) (2.9) |
| Balance at June 28, 2014 | \$0.6 | \$— | \$0.6 |

The Company expects to incur approximately \$0.3 million of additional costs in fiscal 2014 in connection with the exit of retail operations in Japan. Payments under the accruals as of June 28, 2014 are expected to be paid by the end of fiscal 2014.

NOTE 15 – RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, an accounting standard update was issued that clarifies the principles for recognizing revenue. The guidance is applicable to all contracts with customers regardless of industry-specific or transaction-specific fact patterns. Further, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenue that is recognized. The standard is effective for the Company beginning in the first quarter of fiscal 2017, including interim periods within that fiscal year. Early application is not permitted. Upon becoming effective, the Company will apply the amendments in the updated standard either retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application. The Company is evaluating the impact of adopting this standard on its consolidated financial position, results of operations, and cash flows.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 16 – GUARANTOR CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The Company's senior notes constitute debt obligations of TWCC (the "Issuer"), are unsecured and are fully and unconditionally guaranteed by Carter's, Inc. (the "Parent"), and by each of the Company's current domestic subsidiaries, and, subject to certain exceptions, future restricted subsidiaries that guarantee the Company's senior secured revolving credit facility or certain other debt of the Company or the subsidiary guarantors.

The condensed consolidating financial information for the Parent, the Issuer and the guarantor and non-guarantor subsidiaries has been prepared from the books and records maintained by the Company. The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10. The financial information may not necessarily be indicative of the financial position, results of operations, comprehensive income, and cash flows, had the Parent, Issuer, guarantor or non-guarantor subsidiaries operated as independent entities.

Intercompany revenues and expenses included in the subsidiary records are eliminated in consolidation. As a result of this activity, an amount due to/due from affiliates will exist at any time. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions. The Company has accounted for investments in subsidiaries under the equity method. The guarantor subsidiaries are 100% owned directly or indirectly by the Parent and all guarantees are joint, several and unconditional.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CARTER'S, INC.

Condensed Consolidating Balance Sheets

As of June 28, 2014

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| ASSETS | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | \$— | \$191,491 | \$— | \$ 16,429 | \$— | \$207,920 |
| Accounts receivable, net | — | 112,126 | 15,924 | 5,835 | — | 133,885 |
| Intercompany receivable | — | 57,106 | 92,532 | 12,800 | (162,438) | — |
| Intercompany loan receivable | — | 10,000 | — | — | (10,000) | — |
| Finished goods inventories, net | — | 299,688 | 212,817 | 57,369 | (31,641) | 538,233 |
| Prepaid expenses and other current assets | — | 23,700 | 13,906 | 6,078 | — | 43,684 |
| Deferred income taxes | — | 22,136 | 13,130 | 1,268 | — | 36,534 |
| Total current assets | — | 716,247 | 348,309 | 99,779 | (204,079) | 960,256 |
| Property, plant, and equipment, net | — | 157,289 | 140,538 | 27,848 | — | 325,675 |
| Goodwill | — | 136,570 | — | 49,603 | — | 186,173 |
| Tradenames and other intangibles, net | — | 232,776 | 85,500 | 70 | — | 318,346 |
| Deferred debt issuance costs, net | — | 7,407 | — | — | — | 7,407 |
| Other assets | — | 11,305 | — | — | — | 11,305 |
| Intercompany long term receivable | — | — | 221,496 | — | (221,496) | — |
| Intercompany long term note receivable | — | 100,000 | — | — | (100,000) | — |
| Investment in subsidiaries | 720,372 | 562,665 | 4,725 | — | (1,287,762) | — |
| Total assets | \$720,372 | \$1,924,259 | \$800,568 | \$ 177,300 | \$(1,813,337) | \$1,809,162 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | \$— | \$105,126 | \$35,802 | \$ 23,271 | \$— | \$164,199 |
| Intercompany payables | — | 90,697 | 64,911 | 6,830 | (162,438) | — |
| Intercompany loan payables | — | — | — | 10,000 | (10,000) | — |
| Other current liabilities | — | 29,830 | 29,830 | 15,901 | — | 75,561 |
| Total current liabilities | — | 225,653 | 130,543 | 56,002 | (172,438) | 239,760 |
| Long-term debt | — | 586,000 | — | — | — | 586,000 |
| Deferred income taxes | — | 71,822 | 43,056 | — | — | 114,878 |
| | — | 221,496 | — | — | (221,496) | — |

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| | | | | | | |
|--|-----------|-------------|-----------|------------|----------------|-------------|
| Intercompany long term liability | | | | | | |
| Intercompany long term note payable | — | — | 100,000 | — | (100,000) | — |
| Other long-term liabilities | — | 67,275 | 61,039 | 19,838 | — | 148,152 |
| Stockholders' equity | 720,372 | 752,013 | 465,930 | 101,460 | (1,319,403) | 720,372 |
| Total liabilities and stockholders' equity | \$720,372 | \$1,924,259 | \$800,568 | \$ 177,300 | \$(1,813,337) | \$1,809,162 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of December 28, 2013

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| ASSETS | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | \$— | \$278,260 | \$— | \$8,286 | \$— | \$286,546 |
| Accounts receivable, net | — | 163,264 | 20,365 | 9,982 | — | 193,611 |
| Intercompany receivable | — | 62,802 | 104,123 | 12,385 | (179,310) | — |
| Finished goods inventories, net | — | 221,462 | 181,889 | 46,217 | (31,814) | 417,754 |
| Prepaid expenses and other current assets | — | 18,475 | 11,878 | 4,804 | — | 35,157 |
| Deferred income taxes | — | 20,594 | 15,893 | 826 | — | 37,313 |
| Total current assets | — | 764,857 | 334,148 | 82,500 | (211,124) | 970,381 |
| Property, plant, and equipment, net | — | 148,671 | 133,846 | 25,368 | — | 307,885 |
| Goodwill | — | 136,570 | — | 49,507 | — | 186,077 |
| Tradenames and other intangibles, net | — | 244,653 | 85,500 | 105 | — | 330,258 |
| Deferred debt issuance costs, net | — | 8,088 | — | — | — | 8,088 |
| Other assets | — | 9,743 | 52 | — | — | 9,795 |
| Intercompany long term receivable | — | — | 263,183 | — | (263,183) | — |
| Intercompany long term note receivable | — | 100,000 | — | — | (100,000) | — |
| Investment in subsidiaries | 700,731 | 547,186 | 1,262 | — | (1,249,179) | — |
| Total assets | \$700,731 | \$1,959,768 | \$817,991 | \$157,480 | \$(1,823,486) | \$1,812,484 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | \$— | \$108,851 | \$40,825 | \$14,334 | \$— | \$164,010 |
| Intercompany payables | — | 100,804 | 70,857 | 7,649 | (179,310) | — |
| Other current liabilities | — | 29,037 | 57,610 | 18,482 | — | 105,129 |
| Total current liabilities | — | 238,692 | 169,292 | 40,465 | (179,310) | 269,139 |
| Long-term debt | — | 586,000 | — | — | — | 586,000 |
| Deferred income taxes | — | 77,798 | 43,636 | — | — | 121,434 |
| Intercompany long term liability | — | 263,183 | — | — | (263,183) | — |
| Intercompany long term note payable | — | — | 100,000 | — | (100,000) | — |
| Other long-term liabilities | — | 61,550 | 55,175 | 18,455 | — | 135,180 |

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| | | | | | | |
|--|-----------|-------------|-----------|-----------|----------------|-------------|
| Stockholders' equity | 700,731 | 732,545 | 449,888 | 98,560 | (1,280,993) | 700,731 |
| Total liabilities and stockholders' equity | \$700,731 | \$1,959,768 | \$817,991 | \$157,480 | \$(1,823,486) | \$1,812,484 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of June 29, 2013
(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-------------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| ASSETS | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | \$— | \$290,555 | \$— | \$ 21,577 | \$— | \$312,132 |
| Accounts receivable, net | — | 113,079 | 14,057 | 6,141 | — | 133,277 |
| Intercompany receivable | — | 56,330 | 60,907 | 7,546 | (124,783) | — |
| Finished goods inventories, net | — | 242,682 | 192,162 | 34,015 | (39,636) | 429,223 |
| Prepaid expenses and other current assets | — | 28,189 | 17,128 | 3,304 | — | 48,621 |
| Deferred income taxes | — | 22,915 | 9,188 | 845 | — | 32,948 |
| Total current assets | — | 753,750 | 293,442 | 73,428 | (164,419) | 956,201 |
| Property, plant, and equipment, net | — | 83,877 | 100,245 | 23,972 | — | 208,094 |
| Goodwill | — | 136,570 | — | 50,387 | — | 186,957 |
| Tradenames and other intangibles, net | — | 257,240 | 85,500 | 143 | — | 342,883 |
| Deferred debt issuance costs, net | — | 2,486 | — | — | — | 2,486 |
| Other assets | — | 5,047 | 83 | — | — | 5,130 |
| Intercompany long term receivable | — | — | 169,849 | — | (169,849) | — |
| Investment in subsidiaries | 1,020,937 | 515,090 | 4,361 | — | (1,540,388) | — |
| Total assets | \$1,020,937 | \$1,754,060 | \$653,480 | \$ 147,930 | \$(1,874,656) | \$1,701,751 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | — | 151,068 | 39,549 | 8,971 | — | 199,588 |
| Intercompany payables | — | 50,569 | 59,542 | 14,672 | (124,783) | — |
| Other current liabilities | — | 33,829 | 25,176 | 15,057 | — | 74,062 |
| Total current liabilities | — | 235,466 | 124,267 | 38,700 | (124,783) | 273,650 |
| Long-term debt | — | 186,000 | — | — | — | 186,000 |
| Deferred income taxes | — | 76,674 | 35,497 | — | — | 112,171 |
| Intercompany long term liability | — | 169,849 | — | — | (169,849) | — |
| Other long-term liabilities | — | 25,498 | 57,635 | 25,860 | — | 108,993 |
| Stockholders' equity | 1,020,937 | 1,060,573 | 436,081 | 83,370 | (1,580,024) | 1,020,937 |
| Total liabilities and stockholders' equity | \$1,020,937 | \$1,754,060 | \$653,480 | \$ 147,930 | \$(1,874,656) | \$1,701,751 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CARTER'S, INC.

Condensed Consolidating Statements of Operations

For the fiscal quarter ended June 28, 2014

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|--|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net Sales | \$— | \$338,518 | \$325,673 | \$49,005 | \$(139,131) | \$574,065 |
| Cost of goods sold | — | 246,763 | 187,574 | 25,745 | (131,494) | 328,588 |
| Gross profit | — | 91,755 | 138,099 | 23,260 | (7,637) | 245,477 |
| Selling, general, and administrative expenses | — | 41,068 | 153,552 | 20,470 | (8,775) | 206,315 |
| Royalty Income | — | (5,932) | (4,168) | — | 1,915 | (8,185) |
| Operating Income | — | 56,619 | (11,285) | 2,790 | (777) | 47,347 |
| Interest expense | — | 6,882 | 1,298 | 19 | (1,317) | 6,882 |
| Interest income | — | (1,452) | — | (5) | 1,317 | (140) |
| (Income) loss in subsidiaries | (25,897) | 13,359 | (6,192) | — | 18,730 | — |
| Other (income) expense, net | — | (78) | 58 | (169) | — | (189) |
| Income (loss) before income taxes | 25,897 | 37,908 | (6,449) | 2,945 | (19,507) | 40,794 |
| Provision for income taxes | — | 11,234 | 2,181 | 1,482 | — | 14,897 |
| Net income (loss) | \$25,897 | \$26,674 | \$(8,630) | \$1,463 | \$(19,507) | \$25,897 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the fiscal quarter ended June 29, 2013
(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|--|----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net Sales | \$— | \$333,259 | \$299,417 | \$50,384 | \$(165,186) | \$517,874 |
| Cost of goods sold | — | 239,891 | 164,110 | 19,908 | (126,280) | 297,629 |
| Gross profit | — | 93,368 | 135,307 | 30,476 | (38,906) | 220,245 |
| Selling, general, and administrative expenses | — | 58,175 | 149,870 | 20,778 | (33,809) | 195,014 |
| Royalty Income | — | (5,790) | (3,471) | — | 1,754 | (7,507) |
| Operating Income | — | 40,983 | (11,092) | 9,698 | (6,851) | 32,738 |
| Interest expense | — | 1,254 | — | — | — | 1,254 |
| Interest income | — | (132) | — | (62) | — | (194) |
| (Income) loss in subsidiaries | (19,673) | 3,867 | (5,725) | — | 21,531 | — |
| Other (income) expense, net | — | (86) | 111 | 506 | — | 531 |
| Income (loss) before income taxes | 19,673 | 36,080 | (5,478) | 9,254 | (28,382) | 31,147 |
| Provision for income taxes | — | 9,556 | 51 | 1,867 | — | 11,474 |
| Net income (loss) | \$19,673 | \$26,524 | \$(5,529) | \$7,387 | \$(28,382) | \$19,673 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the two fiscal quarters ended June 28, 2014
(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|--|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net Sales | \$— | \$745,883 | \$647,381 | \$98,163 | \$(265,718) | \$1,225,709 |
| Cost of goods sold | — | 540,536 | 375,594 | 55,804 | (253,427) | 718,507 |
| Gross profit | — | 205,347 | 271,787 | 42,359 | (12,291) | 507,202 |
| Selling, general, and administrative expenses | — | 89,595 | 299,969 | 43,402 | (16,556) | 416,410 |
| Royalty Income | — | (13,977) | (8,195) | — | 4,086 | (18,086) |
| Operating Income | — | 129,729 | (19,987) | (1,043) | 179 | 108,878 |
| Interest expense | — | 13,780 | 2,611 | 43 | (2,654) | 13,780 |
| Interest income | — | (2,922) | — | (4) | 2,654 | (272) |
| (Income) loss in subsidiaries | (60,193) | 30,794 | (6,778) | — | 36,177 | — |
| Other (income) expense, net | — | (134) | 114 | 427 | — | 407 |
| Income (loss) before income taxes | 60,193 | 88,211 | (15,934) | (1,509) | (35,998) | 94,963 |
| Provision for income taxes | — | 28,197 | 5,921 | 652 | — | 34,770 |
| Net income (loss) | \$60,193 | \$60,014 | \$(21,855) | \$(2,161) | \$(35,998) | \$60,193 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the two fiscal quarters ended June 29, 2013
(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|--|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net Sales | \$— | \$702,877 | \$614,230 | \$87,422 | \$(295,646) | \$1,108,883 |
| Cost of goods sold | — | 495,653 | 342,998 | 41,549 | (234,624) | 645,576 |
| Gross profit | — | 207,224 | 271,232 | 45,873 | (61,022) | 463,307 |
| Selling, general, and administrative expenses | — | 103,298 | 296,720 | 41,258 | (60,901) | 380,375 |
| Royalty Income | — | (12,621) | (7,495) | — | 3,367 | (16,749) |
| Operating Income | — | 116,547 | (17,993) | 4,615 | (3,488) | 99,681 |
| Interest expense | — | 2,547 | — | — | — | 2,547 |
| Interest income | — | (262) | (2) | (120) | — | (384) |
| (Income) loss in subsidiaries | (61,088) | 15,231 | (1,397) | — | 47,254 | — |
| Other (income) expense, net | — | (161) | 186 | 1,079 | — | 1,104 |
| Income (loss) before income taxes | 61,088 | 99,192 | (16,780) | 3,656 | (50,742) | 96,414 |
| Provision for income taxes | — | 34,616 | (921) | 1,631 | — | 35,326 |
| Net income (loss) | \$61,088 | \$64,576 | \$(15,859) | \$2,025 | \$(50,742) | \$61,088 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CARTER'S, INC.

Condensed Consolidating Statements of Comprehensive Income

For the fiscal quarter ended June 28, 2014

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net income (loss) | \$ 25,897 | \$ 26,674 | \$ (8,630) | \$ 1,463 | \$ (19,507) | \$ 25,897 |
| Post-retirement benefit plans | — | — | — | — | — | — |
| Foreign currency translation adjustments | 2,792 | — | — | 2,792 | (2,792) | 2,792 |
| Comprehensive income (loss) | \$ 28,689 | \$ 26,674 | \$ (8,630) | \$ 4,255 | \$ (22,299) | \$ 28,689 |

For the fiscal quarter ended June 29, 2013

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net income (loss) | \$ 19,673 | \$ 26,524 | \$ (5,529) | \$ 7,387 | \$ (28,382) | \$ 19,673 |
| Post-retirement benefit plans | — | — | — | — | — | — |
| Foreign currency translation adjustments | (2,537) | — | — | (2,537) | 2,537 | (2,537) |
| Comprehensive income (loss) | \$ 17,136 | \$ 26,524 | \$ (5,529) | \$ 4,850 | \$ (25,845) | \$ 17,136 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the two fiscal quarters ended June 28, 2014
(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net income (loss) | \$ 60,193 | \$ 60,014 | \$(21,855) | \$ (2,161) | \$(35,998) | \$ 60,193 |
| Post-retirement benefit plans | — | — | — | — | — | — |
| Foreign currency translation adjustments | 32 | — | — | 32 | (32) | 32 |
| Comprehensive income (loss) | \$ 60,225 | \$ 60,014 | \$(21,855) | \$ (2,129) | \$(36,030) | \$ 60,225 |

For the two fiscal quarters ended June 29, 2013
(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Net income (loss) | \$ 61,088 | \$ 64,576 | \$(15,859) | \$ 2,025 | \$(50,742) | \$ 61,088 |
| Post-retirement benefit plans | — | — | — | — | — | — |
| Foreign currency translation adjustments | (4,002) | — | — | (4,002) | 4,002 | (4,002) |
| Comprehensive income (loss) | \$ 57,086 | \$ 64,576 | \$(15,859) | \$ (1,977) | \$(46,740) | \$ 57,086 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CARTER'S, INC.

Condensed Consolidating Statements of Cash Flows

For the two fiscal quarters ended June 28, 2014

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|--|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Cash flows provided by (used in) operating activities: | \$— | \$54,656 | \$(26,855) | \$ 5,323 | \$— | \$33,124 |
| Cash flows from investing activities: | | | | | | |
| Capital expenditures | — | (33,691) | (21,719) | (5,890) | — | (61,300) |
| Intercompany investing activity | 54,163 | 4,442 | (2,144) | — | (56,461) | — |
| Issuance of intercompany loan | — | (10,000) | — | — | 10,000 | — |
| Proceeds from sale of property, plant and equipment | — | 134 | — | — | — | 134 |
| Net cash provided by (used in) investing activities | 54,163 | (39,115) | (23,863) | (5,890) | (46,461) | (61,166) |
| Cash flows from financing activities: | | | | | | |
| Intercompany financing activity | — | (103,802) | 48,574 | (1,233) | 56,461 | — |
| Proceeds from intercompany loan | — | — | — | 10,000 | (10,000) | — |
| Payment on debt issuance costs | — | (114) | — | — | — | (114) |
| Dividends paid | (20,380) | — | — | — | — | (20,380) |
| Repurchase of common stock | (36,080) | — | — | — | — | (36,080) |
| Income tax benefit from stock-based compensation | — | 1,606 | 2,144 | — | — | 3,750 |
| Withholdings from vesting of restricted stock | (4,251) | — | — | — | — | (4,251) |
| Proceeds from exercise of stock options | 6,548 | — | — | — | — | 6,548 |
| Net cash (used in) provided by financing activities | (54,163) | (102,310) | 50,718 | 8,767 | 46,461 | (50,527) |
| Effect of exchange rate changes on cash | — | — | — | (57) | — | (57) |

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| | | | | | | | | |
|--|-----|-----------|-----|----------|-------|-----------|---------|---|
| Net (decrease) increase in cash and cash equivalents | — | (86,769 |) | — | 8,143 | — | (78,626 |) |
| Cash and cash equivalents, beginning of period | — | 278,260 | — | 8,286 | — | 286,546 | | |
| Cash and cash equivalents, end of period | \$— | \$191,491 | \$— | \$16,429 | \$— | \$207,920 | | |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the two fiscal quarters ended June 29, 2013

(dollars in thousands)

| | Parent | Subsidiary Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|--|-----------|----------------------|---------------------------|-------------------------------|------------------------------|--------------|
| Cash flows provided by (used in) operating activities: | \$— | \$67,883 | \$(1,075) | \$ 3,032 | \$— | \$69,840 |
| Cash flows from investing activities: | | | | | | |
| Capital expenditures | — | (48,114) | (15,827) | (6,625) | — | (70,566) |
| Acquisition of tradenames | — | (38,007) | — | — | — | (38,007) |
| Intercompany investing activity | 40,608 | 10,174 | (6,032) | — | (44,750) | — |
| Net cash provided by (used in) investing activities | 40,608 | (75,947) | (21,859) | (6,625) | (44,750) | (108,573) |
| Cash flows from financing activities: | | | | | | |
| Intercompany financing activity | — | (59,664) | 12,490 | 2,424 | 44,750 | — |
| Dividends Paid | (9,522) | — | — | — | — | (9,522) |
| Income tax benefit from stock-based compensation | — | 6,425 | 3,504 | — | — | 9,929 |
| Repurchase of common stock | (37,757) | — | — | — | — | (37,757) |
| Withholdings from vesting of restricted stock | (4,539) | — | — | — | — | (4,539) |
| Proceeds from exercise of stock options | 11,210 | — | — | — | — | 11,210 |
| Net cash (used in) provided by financing activities | (40,608) | (53,239) | 15,994 | 2,424 | 44,750 | (30,679) |
| Effect of exchange rate changes on cash | — | — | — | (692) | — | (692) |
| Net decrease in cash and cash equivalents | — | (61,303) | (6,940) | (1,861) | — | (70,104) |
| Cash and cash equivalents, beginning of period | — | 351,858 | 6,940 | 23,438 | — | 382,236 |
| | \$— | \$290,555 | \$— | \$ 21,577 | \$— | \$312,132 |

Cash and cash
equivalents, end of
period

28

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 condition. This should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes and our Annual Report on Form 10-K for the fiscal year ended December 28, 2013.

Our Business

We are the largest branded marketer in the United States of apparel exclusively for babies and young children. We own two of the most highly recognized and most trusted brand names in the children's apparel industry, Carter's and OshKosh

B'gosh ("OshKosh"). Established in 1865, our Carter's brand is recognized and trusted by consumers for high-quality apparel

for children sizes newborn to seven. Established in 1895, OshKosh is a well-known brand, trusted by consumers for its line of

apparel for children sizes newborn to 12, with a focus on playclothes for toddlers and young children. Given each brand's product category emphasis and brand aesthetic, we believe the brands provide a complementary product offering. We have extensive experience in the young children's apparel market and focus on delivering products that satisfy our consumers' needs. Our strategy is to market high-quality, essential core products at prices that deliver an attractive value proposition for consumers.

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

RESULTS OF OPERATIONS

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

| | Fiscal quarter ended | | Two fiscal quarters ended | | |
|---|----------------------|------------------|---------------------------|------------------|----|
| | June 28, 2014 | June 29, 2013 | June 28, 2014 | June 29, 2013 | |
| Net sales | | | | | |
| Carter's Wholesale | 34.8 | % 38.0 | % 38.5 | % 40.1 | % |
| Carter's Retail | 40.7 | % 38.5 | % 37.9 | % 36.8 | % |
| Total Carter's | 75.5 | % 76.5 | % 76.4 | % 76.9 | % |
| OshKosh Retail | 11.8 | % 10.9 | % 10.7 | % 10.1 | % |
| OshKosh Wholesale | 2.0 | % 2.2 | % 2.2 | % 2.7 | % |
| Total OshKosh | 13.8 | % 13.1 | % 12.9 | % 12.8 | % |
| International | 10.7 | % 10.4 | % 10.7 | % 10.3 | % |
| Consolidated net sales | 100.0 | % 100.0 | % 100.0 | % 100.0 | % |
| Cost of goods sold | 57.2 | % 57.5 | % 58.6 | % 58.2 | % |
| Gross margin | 42.8 | % 42.5 | % 41.4 | % 41.8 | % |
| Selling, general, and administrative expenses | 35.9 | % 37.7 | % 34.0 | % 34.3 | % |
| Royalty Income | (1.4) |)% (1.4 |)% (1.5 |)% (1.5 |)% |
| Operating income | 8.3 | % 6.3 | % 8.9 | % 9.0 | % |
| Interest expense | 1.2 | % 0.2 | % 1.1 | % 0.2 | % |
| Interest income | — | % — | | | |