CARTERS INC
Form 10-Q
October 25, 2018

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 29, 2018 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, a smaller reporting company, or an emerging growth company. See definition of “large accelerated filer," "accelerated filer," "smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one)
Large Accelerated Filer (X) Accelerated Filer ( )
Non-Accelerated Filer ( ) (Do not check if a smaller reporting company) Smaller Reporting Company ( )
Emerging Growth Company ( )

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ( )

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

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 October 19, 2018 |
|---|---|
| Common stock, par value $0.01 per share | 45,848,908 |

CARTER’S, INC.
INDEX

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CARTER'S, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(dollars in thousands, except per share data)
(unaudited)

| | September 29, 2018 | December 30, 2017 | September 30, 2017 |
|---|---|---|---|
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 123,898 | $ 178,494 | $ 105,370 |
| Accounts receivable, net | 293,489 | 240,561 | 285,651 |
| Finished goods inventories | 692,985 | 548,722 | 609,996 |
| Prepaid expenses and other current assets | 57,000 | 52,935 | 50,956 |
| Total current assets | 1,167,372 | 1,020,712 | 1,051,973 |
| Property, plant, and equipment, net of accumulated depreciation of $450,460, $404,173, and $387,041, respectively | 360,718 | 377,924 | 382,014 |
| Tradenames, net | 365,754 | 365,551 | 365,595 |
| Goodwill | 229,611 | 230,424 | 234,193 |
| Customer relationships, net | 45,525 | 47,996 | 46,622 |
| Other assets | 28,966 | 28,435 | 26,539 |
| Total assets | $ 2,197,946 | $ 2,071,042 | $ 2,106,936 |
| | | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | $ 185,285 | $ 182,114 | $ 193,878 |
| Other current liabilities | 133,021 | 149,134 | 137,114 |
| Total current liabilities | 318,306 | 331,248 | 330,992 |
| | | | |
| Long-term debt, net | 798,020 | 617,306 | 687,074 |
| Deferred income taxes | 87,888 | 84,944 | 138,161 |
| Other long-term liabilities | 182,547 | 180,128 | 178,878 |
| Total liabilities | $ 1,386,761 | $ 1,213,626 | $ 1,335,105 |
| | | | |
| Commitments and contingencies - Note 14 | | | |
| | | | |
| Stockholders' equity: | | | |
| Preferred stock; par value $.01 per share; 100,000 shares authorized; none issued or outstanding at September 29, 2018, December 30, 2017, and September 30, 2017 | $ — | $ — | $ — |
| Common stock, voting; par value $.01 per share; 150,000,000 shares authorized; 46,041,329, 47,178,346 and 47,419,316 shares issued and outstanding at September 29, 2018, December 30, 2017 and September 30, 2017, respectively | 460 | 472 | 474 |
| Accumulated other comprehensive loss | (32,318) | (29,093) | (26,496) |
| Retained earnings | 843,043 | 886,037 | 797,853 |
| Total stockholders' equity | 811,185 | 857,416 | 771,831 |
| Total liabilities and stockholders' equity | $ 2,197,946 | $ 2,071,042 | $ 2,106,936 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | Fiscal quarter ended | | Three fiscal quarters ended | |
|---|---|---|---|---|
| | September 29, 2018 | September 30, 2017 | September 29, 2018 | September 30, 2017 |
| Net sales | $923,907 | $ 948,046 | $2,375,890 | $ 2,372,624 |
| Cost of goods sold | 536,457 | 544,468 | 1,346,005 | 1,350,107 |
| Gross profit | 387,450 | 403,578 | 1,029,885 | 1,022,517 |
| Royalty income, net | 10,224 | 10,350 | 28,573 | 32,118 |
| Selling, general, and administrative expenses | 294,117 | 283,480 | 837,621 | 781,420 |
| Operating income | 103,557 | 130,448 | 220,837 | 273,215 |
| Interest expense | 9,868 | 8,061 | 25,790 | 22,359 |
| Interest income | (84) | (41) | (474) | (259) |
| Other expense (income), net | (66) | (815) | 528 | (1,580) |
| Income before income taxes | 93,839 | 123,243 | 194,993 | 252,695 |
| Provision for income taxes | 22,069 | 40,927 | 43,487 | 85,992 |
| Net income | $71,770 | $ 82,316 | $151,506 | $ 166,703 |
| | | | | |
| Basic net income per common share | $1.55 | $ 1.73 | $3.24 | $ 3.46 |
| Diluted net income per common share | $1.53 | $ 1.71 | $3.20 | $ 3.42 |
| Dividend declared and paid per common share | $0.45 | $ 0.37 | $1.35 | $ 1.11 |

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 | | Three fiscal quarters ended | |
|---|---|---|---|---|
| | September 29, 2018 | September 30, 2017 | September 29, 2018 | September 30, 2017 |
| Net income | $71,770 | $ 82,316 | $151,506 | $ 166,703 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | 3,213 | 4,157 | (3,225) | 8,244 |
| Comprehensive income | $74,983 | $ 86,473 | $148,281 | $ 174,947 |

See accompanying notes to the unaudited condensed consolidated financial statements.

CARTER'S, INC.
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(amounts in thousands, except share amounts)
(unaudited)

| | Common stock - shares | Common stock - $ | Additional paid-in capital | Accumulated other comprehensive loss | Retained earnings | Total stockholders' equity |
|---|---|---|---|---|---|---|
| Balance at December 30, 2017 | 47,178,346 | $ 472 | $ — | $ (29,093 ) | $ 886,037 | $ 857,416 |
| Exercise of stock options | 160,363 | 2 | 8,730 | — | — | 8,732 |
| Withholdings from vesting of restricted stock | (56,668 ) | (1 ) | (6,746) | — | — | (6,747 ) |
| Restricted stock activity | 123,708 | 1 | (1 ) | — | — | — |
| Stock-based compensation expense | — | — | 12,110 | — | — | 12,110 |
| Repurchase of common stock | (1,364,420 ) | (14 ) | (14,093) | — | (131,386 ) | (145,493 ) |
| Cash dividends declared and paid | — | — | — | — | (63,114 ) | (63,114 ) |
| Comprehensive income | — | — | — | (3,225 ) | 151,506 | 148,281 |
| Balance at September 29, 2018 | 46,041,329 | $ 460 | $ — | $ (32,318 ) | $ 843,043 | $ 811,185 |

See accompanying notes to the unaudited condensed consolidated financial statements.

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

| | Three fiscal quarters ended | |
|---|---|---|
| | September 29, 2018 | September 30, 2017 |
| Cash flows from operating activities: | | |
| Net income | $151,506 | $ 166,703 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation of property, plant, and equipment | 63,441 | 60,455 |
| Amortization of intangible assets | 2,783 | 1,687 |
| Adjustment to earn-out liability | — | (3,600) |
| Amortization of debt issuance costs | 1,303 | 1,143 |
| Stock-based compensation expense | 12,110 | 13,451 |
| Unrealized foreign currency exchange gain, net | (68) | (1,154) |
| Provisions for doubtful accounts receivable from customers | 15,547 | 3,723 |
| Loss on disposal of property, plant, and equipment, net of recoveries | 516 | 602 |
| Deferred income taxes | (3,173) | (1,059) |
| Effect of changes in operating assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (68,333) | (66,021) |
| Finished goods inventories | (145,709) | (81,285) |
| Prepaid expenses and other assets | (5,312) | (18,018) |
| Accounts payable and other liabilities | (3,253) | 40,879 |
| Net cash provided by operating activities | $21,358 | $ 117,506 |
| | | |
| Cash flows from investing activities: | | |
| Capital expenditures | $(47,844) | $ (51,656) |
| Acquisitions of businesses, net of cash acquired | 96 | (159,365) |
| Disposals and recoveries from property, plant, and equipment | 376 | — |
| Net cash used in investing activities | $(47,372) | $ (211,021) |
| | | |
| Cash flows from financing activities: | | |
| Payment of debt issuance costs | $(890) | $ (2,138) |
| Borrowings under secured revolving credit facility | 290,000 | 200,000 |
| Payments on secured revolving credit facility | (110,000) | (93,965) |
| Repurchases of common stock | (145,493) | (150,974) |
| Dividends paid | (63,114) | (53,443) |
| Withholdings from vestings of restricted stock | (6,747) | (5,654) |
| Proceeds from exercises of stock options | 8,732 | 5,140 |
| Net cash used in financing activities | (27,512) | (101,034) |
| | | |
| Effect of exchange rate changes on cash and cash equivalents | (1,070) | 561 |
| Net decrease in cash and cash equivalents | (54,596) | (193,988) |
| Cash and cash equivalents, beginning of period | 178,494 | 299,358 |
| Cash and cash equivalents, end of period | $123,898 | $ 105,370 |

See accompanying notes to the unaudited condensed consolidated financial statements.

5

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

NOTE 1 – THE COMPANY

Carter's, Inc. and its wholly owned subsidiaries (collectively, the "Company," "its," "us" and "our") design, source, and market branded childrenswear and related products under the Carter's, Child of Mine, Just One You, Precious Firsts, Simple Joys, OshKosh B'gosh ("OshKosh"), Skip Hop and other brands. The Company's products are sourced through contractual arrangements with manufacturers worldwide for: 1) wholesale distribution to leading department stores, national chains, and specialty retailers domestically and internationally and 2) distribution to the Company's own retail stores and eCommerce sites that market its brand name merchandise and other licensed products manufactured by other companies. As of September 29, 2018, the Company operated 1,061 retail stores in the United States, Canada, and Mexico.

NOTE 2 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and the rules and regulations of the Securities and Exchange Commission (the "SEC"). All intercompany transactions and balances have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all normal and recurring adjustments necessary to state fairly the consolidated financial condition, results of operations, comprehensive income, statement of stockholders' equity, and cash flows of the Company for the interim periods presented. Except as otherwise disclosed, all such adjustments consist only of those of a normal recurring nature. Operating results for the fiscal quarter and three fiscal quarters ended September 29, 2018 are not necessarily indicative of the results that may be expected for the current fiscal year ending December 29, 2018.

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

The accompanying condensed consolidated balance sheet as of December 30, 2017 was derived from the Company's audited consolidated financial statements included in its most recently filed Annual Report on Form 10-K. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules and regulations of the SEC and the instructions to Form 10-Q. As disclosed in Note 2, Basis of Presentation, and Note 3, Revenue Recognition, at the beginning of fiscal 2018 the Company adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification (“ASC”) No. 606, Revenue from Contracts with Customers, and related amendments (“ASC 606”) using the full retrospective adoption method. The full retrospective method required the Company to apply the standard to the financial statements for the period of adoption as well as to each prior reporting period presented.

Accounting Policies

The accounting policies the Company follows are set forth in its most recently filed Annual Report on Form 10-K. There have been no material changes to these accounting policies, except as noted below for new accounting pronouncements adopted at the beginning of fiscal 2018.

Revenue from Contracts with Customers (ASC No. 606)

At the beginning of fiscal 2018, the Company adopted the provisions of ASC No. 606, Revenue from Contracts with Customers, and all related amendments (“ASC 606”) using the full retrospective adoption method. Refer to Note 3, Revenue Recognition, for additional information.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company uses the five-step model to recognize revenue:
1) Identify the contract with the customer;
2) Identity the performance obligation(s);
3) Determine the transaction price;
4) Allocate the transaction price to each performance obligation if multiple obligations exist; and
5) Recognize the revenue as the performance obligations are satisfied

Performance Obligations

The Company identifies each distinct performance obligation to transfer goods (or bundle of goods). The Company recognizes revenue when (or as) it satisfies a performance obligation by transferring control of the goods to the customer. Other than inbound and outbound freight and shipping arrangements, the Company does not use third parties to satisfy its performance obligations in revenue arrangements with customers.

When Performance Obligations Are Satisfied

Wholesale Revenues - The Company typically transfers control upon shipment. However, in certain arrangements where the Company retains the risk of loss during shipment, satisfaction of the performance obligation occurs when the goods reach the customer.

Retail Revenues - For transactions in stores, the Company satisfies its performance obligation at point of sale when the customer takes possession of the goods and tenders payment. The redemption of loyalty points under the Company's rewards program and redemptions of gift cards may be part of a transaction. For purchases made through the Company's eCommerce channel, revenue is recognized when the goods are physically delivered to the customer.

The Company satisfies its performance obligations with licensees over time as customers have the right to use the intellectual property over the contract period.

Significant Payment Terms

Retail customers tender a form of payment, such as cash or a credit/debit card, at point of sale. For wholesale customers and licensees, payment is due based on established terms.

Returns and Refunds

The Company establishes return provisions for retail customers. It is the Company's policy not to accept returns from wholesale customers.

Significant Judgments

Sale of Goods - The Company relies on shipping terms to determine when performance obligations are satisfied. When goods are shipped to wholesale customers "FOB Shipping Point," control of the goods is transferred to the customer at the time of shipment if there are no remaining performance obligations. The Company recognizes the revenue once control passes to the customer. For retail transactions, no significant judgments are involved since revenue is recognized at the point of sale when tender is exchanged and the customer receives the goods.

Royalty Revenues - The Company transfers the right-to-use benefit to the licensee for the contract term and therefore the Company satisfies its performance obligation over time. Revenue recognized for each reporting period is based on the greater of: 1) the royalties owed on actual net sales by the licensee and 2) a minimum royalty guarantee, if applicable.

Transaction Price - The transaction price is the amount of consideration the Company expects to receive under the arrangement. The Company is required to estimate variable consideration (if any) and to factor that estimation into the determination of the transaction price. The Company may offer sales incentives to wholesale and retail customers, including discounts. For retail transactions, the Company has significant experience with return patterns and relies on this experience to estimate expected returns when determining the transaction price.

Standalone Selling Prices - For arrangements that contain multiple performance obligations, the Company allocates the transaction price to each performance obligation on a relative standalone selling price basis.

Costs Incurred to Obtain a Contract - Incremental costs to obtain contracts are not material to the Company.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Policy Elections
In addition to those previously disclosed, the Company has made the following accounting policy elections and practical expedients:
Portfolio Approach - The Company uses the portfolio approach when multiple contracts or performance obligations are involved in the determination of revenue recognition.
Taxes - The Company excludes from the transaction price any taxes collected from customers that are remitted to taxing authorities.
Shipping and Handling Charges - Charges that are incurred before and after the customer obtains control of goods are deemed to be fulfillment costs.
Time Value of Money - The Company's payment terms are less than one year from the transfer of goods. Therefore, the Company does not adjust promised amounts of consideration for the effects of the time value of money.
Disclosure of Remaining Performance Obligations - The Company does not disclose the aggregate amount of the transaction price allocated to remaining performance obligations for contracts that are one year or less in term.
Classification of Costs Related to Defined Benefit Pension and Other Post-retirement Benefit Plans (ASU 2017-07)
At the beginning of fiscal 2018, the Company adopted ASU No. 2017-07, Compensation - Retirement Benefits (Topic 715: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost ("ASU 2017-07"). ASU 2017-07 changes how employers that sponsor defined benefit pension and/or other post-retirement benefit plans present the net periodic benefit costs in the statement of operations. Under this new guidance, an employer's statement of operations presents service cost arising in the current period in the same statement line item as other employee compensation. However, all other components of current period costs related to defined benefit plans, such as prior service costs and actuarial gains and losses, are presented on the statement of operations on a line item outside (or below) operating income. ASU 2017-07 affects only the classification of certain costs on the statement of operations, not the determination of costs. Net periodic pension costs related to the Company's frozen defined benefit pension plan and post-retirement medical benefit plan were not material for the third quarter of fiscal 2018, three fiscal quarters of 2018, or prior periods. Prior period results have not been reclassified on the Company's statement of operations due to materiality.
Modifications to Share-based Compensation Awards (ASU 2017-09)
At the beginning of fiscal 2018, the Company adopted ASU No. 2017-09, Compensation-Stock Compensation Topic 718-Scope of Modification Accounting ("ASU 2017-09"). ASU 2017-09 clarifies when changes to the terms and conditions of share-based payment awards must be accounted for as modifications. Entities apply the modification accounting guidance if the value, vesting conditions, or classification of an award changes. The Company has not modified any share-based payment awards. If the Company modifies share-based payment awards in the future, it will apply the provisions of ASU 2017-09.
Definition of a Business (ASU 2017-01)
At the beginning of fiscal 2018, the Company adopted ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business ("ASU 2017-01"). ASU 2017-01 assists entities in determining if acquired assets constitute the acquisition of a business or the acquisition of assets for accounting and reporting purposes. This distinction is important because goodwill can only be recognized in an acquisition of a business. Prior to ASU 2017-01, if revenues were generated immediately before and after a transaction, the acquisition was typically considered a business. Under ASU 2017-01, entities are required to further assess the substance of the processes they acquire. If the Company commences or completes an acquisition in future periods, it will apply the provisions of ASU 2017-01.
Statement of Cash Flows (ASU 2016-15)
At the beginning of fiscal 2018, the Company adopted ASU No. 2016-15, Statement of Cash Flows (Topic 230) ("ASU 2016-15"). ASU 2016-15 represents a consensus of the FASB’s Emerging Issues Task Force on eight separate issues that, if present, can impact classifications on the statement of cash flows. The guidance requires application using a retrospective transition method. The adoption of ASU 2016-15 only impacted the classification of certain insurance proceeds on the Company's consolidated statement of cash flows for the first three quarters of fiscal 2018.

8

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 - REVENUE RECOGNITION

The Company’s revenues are earned from contracts or arrangements with retail and wholesale customers and licensees. Contracts include written agreements, as well as arrangements that are implied by customary practices or law.

At the beginning of fiscal 2018, the Company adopted the provisions of ASC 606 using the full retrospective adoption method. Under the full retrospective method, the Company adjusted all periods in fiscal 2017 and fiscal 2016 to reflect the provisions of ASC 606, and retained earnings at January 2, 2016 (beginning of fiscal 2016) were adjusted for the cumulative effect for prior periods. Refer to the section "Revenue from Contracts with Customers (ASC No. 606)" in Note 2, Basis of Presentation, for changes to the Company's accounting policies due to the adoption of ASC 606.

ASC 606 affected the Company's retail channels as follows:

- Accelerated the recognition of breakage revenue from unredeemed gift cards, which affected net sales, gross profit, income before income taxes, and net income on the Company's statements of operations. Basic and diluted net income per share were affected by $0.01 or less for each reporting period. Related gift card liabilities and income tax liabilities were also affected.
- A portion of the estimated value of goods expected to be returned by customers was reclassified between net sales and cost of goods sold, with no net effect on gross profit, income before income taxes, or net income on the Company's statement of operations. Related reclassifications were also made between other current assets and other current liabilities on the Company's balance sheets.

The effects of retrospective adoption on the Company's consolidated Statements of Operations were as follows:

| | Third Quarter | Three Fiscal Quarters | Year | Year |
|---|---|---|---|---|
| (dollars in thousands, except per share data) | Fiscal 2017 | Fiscal 2017 | Fiscal 2017 | Fiscal 2016 |
| Net sales | $ (186 ) | $ (480 ) | $ 92 | $ (637 ) |
| Cost of goods sold | $ 84 | $ 110 | $ 52 | $ (7 ) |
| Income before income taxes | $ (270 ) | $ (590 ) | $ 40 | $ (630 ) |
| Net income | $ (170 ) | $ (371 ) | $ 84 | $ (397 ) |
| | | | | |
| Basic net income per common share | $ — | $ (0.01 ) | $ — | $ (0.01 ) |
| Diluted net income per common share | $ — | $ (0.01 ) | $ — | $ — |

The cumulative effect to the Company’s retained earnings at January 2, 2016 was an after-tax increase of approximately $0.6 million.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The effects of adoption of ASC 606 on the Company's consolidated balance sheet at December 30, 2017 were as follows:

| (dollars in thousands) | As Previously Reported | ASC 606 Adjustments | | As Amended for ASC 606 |
|---|---|---|---|---|
| ASSETS | | | | |
| Prepaid expenses and other current assets | $49,892 | $ 3,043 | (1) | $52,935 |
| Total current assets | $1,017,669 | $ 3,043 | | $1,020,712 |
| Total assets | $2,067,999 | $ 3,043 | | $2,071,042 |
| | | | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Other current liabilities | $146,510 | $ 2,624 | (2) | $149,134 |
| Total current liabilities | $328,624 | $ 2,624 | | $331,248 |
| Deferred income taxes | $84,848 | $ 96 | | $84,944 |
| Total liabilities | $1,210,906 | $ 2,720 | | $1,213,626 |
| | | | | |
| Retained earnings | 885,714 | 323 | (3) | 886,037 |
| Total stockholder's equity | $857,093 | $ 323 | | $857,416 |
| | | | | |
| Total liabilities and stockholders' equity | $2,067,999 | $ 3,043 | | $2,071,042 |

(1) Reclassification of estimated inventory expected to be returned by customers through future sales refund transactions. This amount was reclassified from the returns reserve (current liability) to a current asset. Prior to the Company's adoption of ASC 606, the Company's returns reserve (current liability) was reported net of the estimated inventory expected to be returned by customers through sales refund transactions.

(2) Amount includes a reclassification of approximately $3.0 million for estimated inventory expected to be returned by customers, partially offset by a reclassification of approximately $0.4 million for gift card liabilities.

(3) Cumulative impact of approximately $0.6 million for after-tax adjustments to retained earnings at the beginning of fiscal 2016, offset by ASC 606 effects on fiscal 2017 and fiscal 2016 results of operations.

The retrospective adoption of ASC 606 at the beginning of fiscal 2018 also had the following effects on the Company's unaudited condensed consolidated balance sheet at September 30, 2017:

| (dollars in thousands) | As Previously Reported | ASC 606 Adjustments | | As Amended for ASC 606 |
|---|---|---|---|---|
| ASSETS | | | | |
| Prepaid expenses and other current assets | $48,083 | $ 2,873 | (1) | $50,956 |
| Total current assets | $1,049,100 | $ 2,873 | | $1,051,973 |
| Total assets | $2,104,063 | $ 2,873 | | $2,106,936 |
| | | | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Other current liabilities | $134,031 | $ 3,083 | (2) | $137,114 |
| Total current liabilities | $327,909 | $ 3,083 | | $330,992 |
| Deferred income taxes | $138,239 | $ (78 ) | | 138,161 |
| Total liabilities | $1,332,100 | $ 3,005 | | $1,335,105 |
| | | | | |
| Retained earnings | $797,985 | $ (132 ) | (3) | $797,853 |
| Total stockholder's equity | $771,963 | $ (132 ) | | $771,831 |

| | | | |
|---|---|---|---|
| Total liabilities and stockholders' equity | $2,104,063 | $ 2,873 | $2,106,936 |

(1) Reclassification of estimated inventory expected to be returned by customers through future sales refund transactions. This amount was reclassified from the returns reserve (current liability) to a current asset. Prior to the Company's adoption of ASC 606, the Company's returns reserve (current liability) was reported net of the estimated inventory expected to be returned by customers through sales refund transactions.

(2) Amount includes a reclassification of approximately $2.9 million for estimated inventory expected to be returned by customers and an adjustment of approximately $0.2 million for gift card liabilities.

(3) Cumulative impact of approximately $0.6 million for after-tax adjustments to retained earnings at the beginning of fiscal 2016, offset by ASC 606 impact on fiscal 2017 and fiscal 2016 results of operations.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Disaggregation of Revenue

The Company sells its products directly to consumers ("direct-to-consumer") and to other retail companies and partners that subsequently sell the products directly to their own retail customers. The Company also earns royalties from its licensees. Disaggregated revenues from these sources for the third quarter and three quarters ended fiscal 2018 and 2017 were as follows:

| | Fiscal quarter ended September 29, 2018 | | | |
|---|---|---|---|---|
| (dollars in thousands) | U.S. Retail | U.S. Wholesale | International | Total |
| Wholesale channel | $— | $ 338,963 | $ 54,373 | $393,336 |
| Direct-to-consumer | 459,101 | — | 71,470 | 530,571 |
| | $459,101 | $ 338,963 | $ 125,843 | $923,907 |
| | | | | |
| Royalty income | $3,614 | $ 5,891 | $ 719 | $10,224 |

| | Three fiscal quarters ended September 29, 2018 | | | |
|---|---|---|---|---|
| (dollars in thousands) | U.S. Retail | U.S. Wholesale | International | Total |
| Wholesale channel | $— | $ 829,272 | $ 117,255 | $946,527 |
| Direct-to-consumer | 1,244,863 | — | 184,500 | 1,429,363 |
| | $1,244,863 | $ 829,272 | $ 301,755 | $2,375,890 |
| | | | | |
| Royalty income | $9,625 | $ 16,693 | $ 2,255 | $28,573 |

| | Fiscal quarter ended September 30, 2017 | | | |
|---|---|---|---|---|
| (dollars in thousands) | U.S. Retail | U.S. Wholesale | International | Total |
| Wholesale channel | $— | $ 369,577 | $ 55,524 | $425,101 |
| Direct-to-consumer | 453,843 | — | 69,102 | 522,945 |
| | $453,843 | $ 369,577 | $ 124,626 | $948,046 |
| | | | | |
| Royalty income | $3,038 | $ 6,648 | $ 664 | $10,350 |

| | Three fiscal quarters ended September 30, 2017 | | | |
|---|---|---|---|---|
| (dollars in thousands) | U.S. Retail | U.S. Wholesale | International | Total |
| Wholesale channel | $— | $ 879,842 | $ 112,827 | $992,669 |
| Direct-to-consumer | 1,209,143 | — | 170,812 | 1,379,955 |
| | $1,209,143 | $ 879,842 | $ 283,639 | $2,372,624 |
| | | | | |
| Royalty income | $11,201 | $ 18,153 | $ 2,764 | $32,118 |

Accounts Receivable from Customers and Licensees

The components of Accounts receivable, net, were as follows:

| (dollars in thousands) | September 29, 2018 | December 30, 2017 | September 30, 2017 |
|---|---|---|---|
| Trade receivables from wholesale customers, net | $281,190 | $229,968 | $274,238 |
| Royalties receivable | 9,667 | 9,818 | 9,331 |
| Tenant allowances and other receivables | 14,165 | 14,511 | 13,863 |
| Total gross receivables | $305,022 | $254,297 | $297,432 |
| Less: | | | |
| Wholesale accounts receivable reserves | (11,533 ) | (13,736 ) | (11,781 ) |
| Accounts receivable, net | $293,489 | $240,561 | $285,651 |

11

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Contract Assets and Liabilities
The Company's contract assets are not material.
Contract Liabilities
The Company recognizes a contract liability when it has received consideration from the customer and has a future obligation to transfer goods to the customer. Total contract liabilities consisted of the following amounts:

| (dollars in thousands) | September 29, 2018 | December 30, 2017 | September 30, 2017 |
|---|---|---|---|
| Contract liabilities-current: | | | |
| Unredeemed gift cards | $ 11,304 | $ 11,945 | $ 10,236 |
| Unredeemed customer loyalty rewards | 8,441 | 7,355 | 8,485 |
| Total contract liabilities-current(*) | $ 19,745 | $ 19,300 | $ 18,721 |

*Included with Other current liabilities on the Company's consolidated balance sheet.
Composition of Contract Liabilities
Unredeemed gift cards - the Company is obligated to transfer goods in the future to customers who have purchased gift cards. Periodic changes in the gift card contract liability result from the redemption of gift cards by customers and the recognition of estimated breakage revenue for those gift card balances that are not expected to be redeemed. The majority of our gift cards do not have an expiration date; however, all outstanding gift card balances are classified by the Company as current liabilities since gift cards are redeemable on demand by the valid holder. The majority of the Company's gift cards are redeemed within one year of issuance.
Unredeemed loyalty rewards - points and reward certificates earned by customers under the Company’s loyalty programs represent obligations of the Company to transfer goods to the customer upon redemption. Periodic changes in the loyalty program contract liability result from reward certificate redemptions and expirations. The earning and redemption cycles for our loyalty program are under one year in duration.
NOTE 4 – BUSINESS ACQUISITIONS IN FISCAL 2017
Based on their purchase prices and pre-acquisition operating results and assets, neither of the businesses acquired by the Company in fiscal 2017 met the materiality requirements for preparation and presentation of pro forma financial information, either individually or in the aggregate.
Skip Hop Acquisition
Carter's, Inc.'s wholly-owned subsidiary, The William Carter Company ("TWCC"), acquired 100% of the voting equity interests of Skip Hop Holdings, Inc. and subsidiaries (collectively "Skip Hop") after the close of business on February 22, 2017. The Skip Hop purchase was deemed to be the acquisition of a business under the provisions of ASC No. 805, Business Combinations ("ASC 805"). The Company's consolidated financial statements reflect the consolidation of the financial position, results of operations and cash flows of Skip Hop beginning February 23, 2017.
In the Company's unaudited condensed consolidated balance sheet at July 1, 2017, the preliminary purchase price of approximately $147.3 million, net of $0.8 million cash acquired, was comprised of the following acquired assets and assumed liabilities: $54.2 million of goodwill including an assembled workforce; $92.7 million of intangible assets comprised of a tradename and acquired customer relationships; $54.9 million of tangible assets acquired; and $20.2 million of liabilities in addition to $35.9 million of deferred income tax liabilities.
The measurement period (as defined in ASC 805) for Skip Hop was complete at the end of fiscal 2017 and all measurement period adjustments were reflected in the Company's consolidated balance sheet as of December 30, 2017. As a result of the measurement period adjustments recorded between the acquisition date and the end of fiscal 2017, the net assets acquired consisted of the following: $46.0 million of goodwill including an assembled workforce; $104.1 million of intangible assets comprised of a tradename and acquired customer relationships; $53.9 million of tangible assets acquired; and $20.8 million of liabilities in addition to $36.3 million of deferred income tax liabilities. The adjusted purchase price was approximately $142.5 million, net of $0.8 million of cash acquired.
Acquisition of Mexican Licensee
On August 1, 2017, the Company, through certain of its wholly-owned subsidiaries, acquired the outstanding equity of the Company's licensee in Mexico and a related entity (collectively "Carter's Mexico"). Both entities are incorporated

under

12

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Mexican law. Prior to the acquisition, Carter's Mexico was primarily a licensee and wholesale customer of the Company. The Carter's Mexico purchase was deemed to be the acquisition of a business under the provisions of ASC 805. The Company's consolidated financial statements reflect the consolidation of the financial position, results of operations and cash flows of Carter's Mexico beginning August 1, 2017. Carter's Mexico became part of the Company's International reportable segment.

As of December 30, 2017, preliminary values assigned to assets acquired included inventories of approximately $8.3 million, a customer relationships intangible asset of approximately $3.5 million, and goodwill of approximately $6.2 million. Measurement period adjustments made in the first quarter of fiscal 2018 were not material.

The measurement period (as defined in ASC 805) for the acquisition of Carter's Mexico was completed during the second quarter of fiscal 2018 and all measurement period adjustments were reflected in the Company's consolidated balance sheet as of September 29, 2018. As a result of the measurement period adjustments recorded between the acquisition date and the end of the second quarter of fiscal 2018, the values assigned to assets acquired included inventories of approximately $8.0 million, a customer relationships intangible asset of approximately $3.5 million, and goodwill of approximately $6.3 million.

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive loss consisted of the following:

| (dollars in thousands) | September 29, 2018 | December 30, 2017 | September 30, 2017 |
|---|---|---|---|
| Cumulative foreign currency translation adjustments | $ (24,510 ) | $ (21,285 ) | $ (19,380 ) |
| Pension and post-retirement obligations(*) | (7,808 ) | (7,808 ) | (7,116 ) |
| Total accumulated other comprehensive loss | $ (32,318 ) | $ (29,093 ) | $ (26,496 ) |

(*) Net of income taxes of $4.4 million, $4.4 million, and $4.2 million, respectively. The deferred income taxes associated with these obligations are subject to adjustments upon the Company's adoption of ASC 2018-02. See Note 16, Pending Adoption of Recent Accounting Pronouncements.

During the first three quarters of both fiscal 2018 and fiscal 2017, no amounts were reclassified from accumulated other comprehensive loss to the statement of operations.

NOTE 6 – GOODWILL AND INTANGIBLE ASSETS

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

| | | September 29, 2018 | | | December 30, 2017 | | |
|---|---|---|---|---|---|---|---|
| (dollars in thousands) | Weighted-average useful life | Gross amount | Accumulated amortization | Net amount | Gross amount | Accumulated amortization | Net amount |
| Carter's goodwill | Indefinite | $136,570 | | $136,570 | $136,570 | | $136,570 |
| Canada goodwill | Indefinite | 41,074 | | 41,074 | 42,223 | | 42,223 |
| Skip Hop goodwill | Indefinite | 45,976 | | 45,976 | 45,997 | | 45,997 |
| Carter's Mexico goodwill | Indefinite | 5,991 | | 5,991 | 5,634 | | 5,634 |
| Total goodwill | | $229,611 | | $229,611 | $230,424 | | $230,424 |
| | | | | | | | |
| Carter's tradename | Indefinite | $220,233 | | $220,233 | $220,233 | | $220,233 |
| OshKosh tradename | Indefinite | 85,500 | | 85,500 | 85,500 | | 85,500 |
| Skip Hop tradename | Indefinite | 56,800 | | 56,800 | 56,800 | | 56,800 |
| Finite-life tradenames | 5-20 years | 3,911 | $ 690 | 3,221 | 3,550 | $ 532 | 3,018 |
| Total tradenames, net | | $366,444 | $ 690 | $365,754 | $366,083 | $ 532 | $365,551 |
| | | | | | | | |
| Skip Hop customer relationships | 15 years | $47,300 | $ 4,686 | $42,614 | $47,300 | $ 2,304 | $44,996 |
| Carter's Mexico customer relationships | 10 years | 3,289 | 378 | 2,911 | 3,135 | 135 | 3,000 |
| | | $50,589 | $ 5,064 | $45,525 | $50,435 | $ 2,439 | $47,996 |

Total customer relationships, net

13

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

| | | September 30, 2017 | | |
|---|---|---|---|---|
| (dollars in thousands) | Weighted-average useful life | Gross amount | Accumulated amortization | Net amount |
| Carter's goodwill | Indefinite | $136,570 | | $136,570 |
| Canada goodwill | Indefinite | 42,514 | | 42,514 |
| Skip Hop goodwill | Indefinite | | | |