CARTERS INC
Form 10-Q
August 06, 2008

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 JUNE 28, 2008 OR

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

Commission file number:

001-31829

CARTER'S, INC.
(Exact name of Registrant as specified in its charter)

Delaware (state or other jurisdiction of incorporation or organization)	13-3912933 (I.R.S. Employer Identification No.)

The Proscenium
1170 Peachtree Street NE, Suite 900
Atlanta, Georgia 30309
(Address of principal executive offices, including zip code)

(404) 745-2700
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes (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 “accelerated filer, large 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 ( ) 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 August 6, 2008
Common stock, par value $0.01 per share	56,153,663

CARTER'S, INC.
INDEX

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 28, 2008	December 29, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,223	$ 49,012
Accounts receivable, net	102,593	119,707
Finished goods inventories, net	250,817	225,494
Prepaid expenses and other current assets	15,464	9,093
Assets held for sale	6,109	6,109
Deferred income taxes	23,727	24,234
Total current assets	443,933	433,649
Property, plant, and equipment, net	70,014	75,053
Tradenames	306,733	308,233
Cost in excess of fair value of net assets acquired	136,570	136,570
Deferred debt issuance costs, net	4,176	4,743
Licensing agreements, net	7,087	8,915
Other assets	8,021	7,505
Total assets	$ 976,534	$ 974,668
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 4,379	$ 3,503
Accounts payable	73,822	56,589
Other current liabilities	36,803	46,666
Total current liabilities	115,004	106,758
Long-term debt	336,275	338,026
Deferred income taxes	113,316	113,706
Other long-term liabilities	30,979	34,049
Total liabilities	595,574	592,539
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; par value $.01 per share; 100,000 shares authorized; none issued or outstanding at June 28, 2008 and December 29, 2007	--	--

Common stock, voting; par value $.01 per share; 150,000,000 shares authorized; 56,422,592 and 57,663,315 shares issued and outstanding at June 28, 2008 and December 29, 2007, respectively		564		576
Additional paid-in capital		217,741		232,356
Accumulated other comprehensive income		1,791		2,671
Retained earnings		160,864		146,526
Total stockholders' equity		380,960		382,129
Total liabilities and stockholders' equity	$	976,534	$	974,668

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)

	For the three-month periods ended		For the six-month periods ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Net sales	$ 301,675	$ 287,775	$ 631,647	$ 607,903
Cost of goods sold	202,094	192,357	427,151	406,105
Gross profit	99,581	95,418	204,496	201,798
Selling, general, and administrative expenses	92,207	84,635	184,483	172,881
Intangible asset impairment (Note 3)	--	154,886	--	154,886
Executive retirement charges (Note 13)	5,325	--	5,325	--
Closure costs (Note 10)	--	470	--	4,977
Royalty income	(7,203)	(6,700)	(15,117)	(14,245)
Operating income (loss)	9,252	(137,873)	29,805	(116,701)
Interest expense, net	4,789	5,704	9,309	11,432
Income (loss) before income taxes	4,463	(143,577)	20,496	(128,133)
Provision for (benefit from) income taxes	1,684	(128)	6,158	5,705
Net income (loss)	$ 2,779	$ (143,449)	$ 14,338	$ (133,838)
Basic net income (loss) per common share	$ 0.05	$ (2.48)	$ 0.25	$ (2.30)
Diluted net income (loss) per common share	$ 0.05	$ (2.48)	$ 0.24	$ (2.30)
Basic weighted-average number of shares outstanding	56,156,795	57,838,075	56,685,914	58,142,782
Diluted weighted-average number of shares outstanding	58,163,705	57,838,075	58,741,653	58,142,782

See accompanying notes to the unaudited condensed consolidated financial statements

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

	For the six-month periods ended	
	June 28, 2008	June 30, 2007
Cash flows from operating activities:		
Net income (loss)	$ 14,338	$ (133,838)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	14,150	16,282
Amortization of debt issuance costs	567	583
Non-cash intangible asset impairment charges	--	154,886
Non-cash stock-based compensation expense	5,055	3,057
Income tax benefit from exercised stock options	(60)	(7,038)
Loss on sale of property, plant, and equipment	5	386
Deferred income taxes	552	(7,280)
Non-cash closure costs	--	2,450
Effect of changes in operating assets and liabilities:		
Accounts receivable	17,114	6,081
Inventories	(25,323)	(38,000)
Prepaid expenses and other assets	(7,120)	(6,565)
Accounts payable and other liabilities	4,781	686
Net cash provided by (used in) operating activities	24,059	(8,310)
Cash flows from investing activities:		
Capital expenditures	(7,055)	(7,667)
Proceeds from sale of property, plant, and equipment	--	53
Net cash used in investing activities	(7,055)	(7,614)
Cash flows from financing activities:		
Payments on term loan	(875)	(1,752)
Share repurchase (Note 7)	(20,059)	(40,012)
Income tax benefit from exercised stock options	60	7,038
Proceeds from exercise of stock options	81	1,953
Net cash used in financing activities	(20,793)	(32,773)
Net decrease in cash and cash equivalents	(3,789)	(48,697)
Cash and cash equivalents, beginning of period	49,012	68,545
Cash and cash equivalents, end of period	$ 45,223	$ 19,848

See accompanying notes to the unaudited condensed consolidated financial statements

5

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

	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Total stockholders' equity
Balance at December 29, 2007	$ 576	$ 232,356	$ 2,671	$ 146,526	$ 382,129
Income tax benefit from exercised stock options	--	60	--	--	60
Exercise of stock options (16,070 shares)	--	81	--	--	81
Stock-based compensation expense	--	4,661	--	--	4,661
Issuance of common stock (43,386 shares)	1	629	--	--	630
Share repurchase (1,320,085 shares) (Note 7)	(13)	(20,046)	--	--	(20,059)
Comprehensive income (loss):					
Net income	--	--	--	14,338	14,338
Unrealized loss on interest rate swap, net of tax benefit of $310	--	--	(563)	--	(563)
Unrealized loss on interest rate collar, net of tax benefit of $175	--	--	(317)	--	(317)
Total comprehensive income (loss)	--	--	(880)	14,338	13,458
Balance at June 28, 2008	$ 564	$ 217,741	$ 1,791	$ 160,864	$ 380,960

See accompanying notes to the unaudited condensed consolidated financial statements

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

NOTE 1 – THE COMPANY:

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

NOTE 2 – BASIS OF PREPARATION:

The accompanying unaudited condensed consolidated financial statements comprise the consolidated financial statements of Carter's, Inc. and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

In our opinion, the Company's accompanying unaudited condensed consolidated financial statements contain all adjustments necessary for a fair statement of our financial position as of June 28, 2008, the results of our operations for the three and six-month periods ended June 28, 2008 and June 30, 2007, cash flows for the six-month periods ended June 28, 2008 and June 30, 2007, and changes in stockholders' equity for the six-month period ended June 28, 2008. Operating results for the three and six-month periods ended June 28, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending January 3, 2009. Our accompanying condensed consolidated balance sheet as of December 29, 2007 is from our audited consolidated financial statements included in our most recently filed Annual Report on Form 10-K, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP").

Certain information and footnote disclosure normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission and the instructions to Form 10-Q. The accounting policies we follow are set forth in our most recently filed Annual Report on Form 10-K in the notes to our audited consolidated financial statements for the fiscal year ended December 29, 2007.

Our fiscal year ends on the Saturday, in December or January, nearest the last day of December. The accompanying unaudited condensed consolidated financial statements for the second quarter and first half of fiscal 2008 reflect our financial position as of June 28, 2008. The second quarter and first half of fiscal 2007 ended on June 30, 2007.

Certain prior year amounts have been reclassified for comparative purposes.

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

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

Cost in excess of fair value of net assets acquired represents the excess of the cost of the acquisition of Carter's, Inc. by Berkshire Partners LLC which was consummated on August 15, 2001 (the "2001 acquisition") over the fair value of the net assets acquired. Our cost in excess of fair value of net assets acquired is not deductible for tax purposes.

In connection with the 2001 acquisition, we adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" ("SFAS 141"), and applied the required provisions of SFAS No. 142, "Goodwill and other Intangible Assets" ("SFAS 142"). Accordingly, our Carter's tradename and cost in excess of fair value of net assets acquired have been concluded to have indefinite lives and are not being amortized.

In connection with the acquisition of OshKosh B'Gosh, Inc. on July 14, 2005, (the "Acquisition") the Company recorded cost in excess of fair value of net assets acquired, tradename, licensing, and leasehold interest assets in accordance with SFAS 141. During the second quarter of fiscal 2007, as a result of negative trends in sales and profitability of the Company's OshKosh B'Gosh wholesale and retail segments and re-forecasted projections for such segments for the balance of fiscal 2007, the Company conducted an interim impairment assessment on the value of the intangible assets that the Company recorded in connection with the Acquisition. This assessment was performed in accordance with SFAS 142. Based on this assessment, impairment charges of approximately $36.0 million and $106.9 million were recorded to reflect the impairment of the cost in excess of fair value of net assets acquired for the OshKosh wholesale and retail segments, respectively. In addition, an impairment charge of $12.0 million was recorded to reflect the impairment of the value ascribed to the OshKosh tradename asset. For cost in excess of fair value of net assets acquired, the fair value was determined using the expected present value of future cash flows. For the OshKosh tradename, the fair value was determined using a discounted cash flow analysis which examined the hypothetical cost savings that accrue as a result of our ownership of the tradename.

During the first half of fiscal 2008, approximately $0.9 million of contingencies recorded in connection with the Acquisition were reversed due to settlement with taxing authorities. This reversal resulted in a corresponding reduction to the OshKosh tradename asset of $1.5 million and a reduction in the related deferred tax liability of $0.6 million in accordance with Emerging Issues Task Force ("EITF") No. 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination" ("EITF 93-7").

The Company's intangible assets were as follows:

		June 28, 2008			December 29, 2007		
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount	Gross amount	Accumulated amortization	Net amount
Carter's cost in excess of fair value of net assets acquired	Indefinite	$ 136,570	$ --	$ 136,570	$ 136,570	$ --	$ 136,570
Carter's tradename	Indefinite	$ 220,233	$ --	$ 220,233	$ 220,233	$ --	$ 220,233

OshKosh tradename	Indefinite	$	86,500	$	--	$	86,500	$	88,000	$	--	$	88,000
OshKosh licensing agreements	4.7 years	$	19,100	$	12,013	$	7,087	$	19,100	$	10,185	$	8,915
Leasehold interests	4.1 years	$	1,833	$	1,382	$	451	$	1,833	$	1,149	$	684

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

NOTE 3 – COST IN EXCESS OF FAIR VALUE OF NET ASSETS ACQUIRED AND OTHER INTANGIBLE ASSETS: (Continued)

Amortization expense for intangible assets was approximately $1.0 million and $2.1 million for the three and six-month periods ended June 28, 2008 and $1.2 million and $2.4 million for the three and six-month periods ended June 30, 2007. Annual amortization expense for the OshKosh licensing agreements and leasehold interests is expected to be as follows:

(dollars in thousands)

Fiscal Year	Estimated amortization expense
2008 (period from June 29 through January 3, 2009)	$ 2,044
2009	3,717
2010	1,777
Total	$ 7,538

NOTE 4 – INCOME TAXES:

The Company and its subsidiaries file income tax returns in the United States and in various states and local jurisdictions. The Internal Revenue Service has recently completed an income tax examination for fiscal 2004 and 2005, and has recently begun its audit of fiscal 2006. In most cases, the Company is no longer subject to state and local tax authority examinations for years prior to fiscal 2004.

During the first half of fiscal 2008, we recognized approximately $1.6 million in tax benefits due to the completion of the Internal Revenue Service audit for fiscal 2004 and 2005. In addition, we recognized approximately $0.9 million of pre-Acquisition uncertainties previously reserved for upon completion of these audits. These pre-Acquisition uncertainties have been reflected as a reduction in the OshKosh tradename asset in accordance with EITF 93-7.

As of June 28, 2008, the Company had gross unrecognized tax benefits of approximately $6.7 million. The Company's reserve for unrecognized tax benefits as of June 28, 2008 includes approximately $4.6 million of reserves which, if ultimately recognized, will impact the Company's effective tax rate in the period settled. The reserve for unrecognized tax benefits also includes $1.9 million of reserves which, if ultimately recognized, would be reflected as an adjustment to the Carter's cost in excess of fair value of net assets acquired or the OshKosh tradename asset, and $0.2 million for tax positions for which the ultimate deductibility is highly certain, 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 impact the annual effective tax rate, but would accelerate the payment of cash to the taxing authorities.

Included in the reserves for unrecognized tax benefits are approximately $0.3 million of reserves for which the statute of limitations is expected to expire in the third quarter of fiscal 2008. Such exposures relate primarily to state and local income tax matters. If these tax benefits are ultimately recognized, such recognition may impact our annual effective tax rate for fiscal 2008 and the tax rate in the quarter in which the benefits are recognized. In addition, the reserves for unrecognized tax benefits include approximately $0.6 million of pre-Acquisition reserves for which the statute of limitations is expected to expire in the third quarter of fiscal 2008. Recognition of these uncertainties would be reflected as an additional adjustment to the OshKosh tradename asset in accordance with EITF 93-7.

We recognize interest related to unrecognized tax benefits as a component of interest expense and penalties related to unrecognized tax benefits as a component of income tax expense. The Company had approximately $1.0 million of interest accrued as of June 28, 2008.

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

NOTE 5 – FAIR VALUE MEASUREMENTS:

Effective December 30, 2007 (the first day of our 2008 fiscal year), the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The fair value hierarchy for disclosure of fair value measurements under SFAS 157 is as follows:

Level 1	- Quoted prices in active markets for identical assets or liabilities
Level 2	- Quoted prices for similar assets and liabilities in active markets or inputs that are observable
Level 3	- Inputs that are unobservable (for example, cash flow modeling inputs based on assumptions)

The following table summarizes assets and liabilities measured at fair value on a recurring basis at June 28, 2008, as required by SFAS 157:

(dollars in millions)	Level 1	Level 2	Level 3
Assets			
Investments	$ --	$ --	$ --
Liabilities			
Interest rate swap	$ --	$ 1.2	$ --
Interest rate collar	$ --	$ 1.0	$ --

Our senior credit facility requires us to hedge at least 25% of our variable rate debt under the term loan. On September 22, 2005, we entered into an interest rate swap agreement to receive floating interest and pay fixed interest. This interest rate swap agreement is designated as a cash flow hedge of the variable interest payments on a portion of our variable rate term loan debt. The interest rate swap agreement matures on July 30, 2010. As of June 28, 2008, approximately $139.7 million of our outstanding term loan debt was hedged under this agreement.

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

Both our interest rate swap and collar agreements are traded in the over-the-counter market. Fair values are based on quoted market prices for similar assets or liabilities or determined using inputs that use as their basis readily observable market data that are actively quoted and can be validated through external sources, including third-party pricing services, brokers, and market transactions.

10

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

NOTE 6 – EMPLOYEE BENEFIT PLANS:

Under a defined benefit plan frozen in 1991, we offer a comprehensive post-retirement medical plan to current and certain future retirees and their spouses until they become eligible for Medicare or a Medicare supplement plan. We also offer life insurance to current and certain future retirees. Employee contributions are required as a condition of participation for both medical benefits and life insurance and other liabilities are net of these expected employee contributions. Additionally, we have an obligation under a defined benefit plan covering certain former officers and their spouses. See Note 7 "Employee Benefit Plans" to our audited consolidated financial statements in our most recently filed Annual Report on Form 10-K for further information.

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

(dollars in thousands)	For the three-month periods ended June 28, 2008	June 30, 2007	For the six-month periods ended June 28, 2008	June 30, 2007
Service cost – benefits attributed to service during the period	$ 26	$ 26	$ 53	$ 52
Interest cost on accumulated post-retirement benefit obligation	132	130	263	260
Total net periodic post-retirement benefit cost	$ 158	$ 156	$ 316	$ 312

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

(dollars in thousands)	For the three-month periods ended June 28, 2008	June 30, 2007	For the six-month periods ended June 28, 2008	June 30, 2007
Interest cost on accumulated pension benefit obligation	$ 13	$ 15	$ 26	$ 30

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

During the second quarter of fiscal 2007, the Company liquidated the OshKosh B'Gosh Collective Bargaining Pension Plan (the "Plan"), distributed each participant's balance, and the remaining net assets of $2.2 million were contributed to the Company's defined contribution plan to offset future employer contributions. In connection with the liquidation of the Plan, the Company recorded a pre-tax gain of approximately $0.3 million related to the Plan settlement during the second quarter of fiscal 2007.

11

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

NOTE 6 – EMPLOYEE BENEFIT PLANS: (Continued)

The Company's net periodic pension benefit included in the statements of operations is comprised of:

(dollars in thousands)	For the three-month periods ended June 28, 2008	For the three-month periods ended June 30, 2007	For the six-month periods ended June 28, 2008	For the six-month periods ended June 30, 2007
Interest cost on accumulated pension benefit obligation	$ 562	$ 552	$ 1,124	$ 1,103
Expected return on assets	(944)	(1,404)	(1,887)	(2,316)
Amortization of actuarial gain	(19)	(35)	(38)	(70)
Gain on settlement	--	(276)	--	(276)
Total net periodic pension benefit	$ (401)	$ (1,163)	$ (801)	$ (1,559)

NOTE 7 – COMMON STOCK:

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

During the second quarter and first half of fiscal 2008, the Company repurchased and retired approximately $10 million and $20 million, or 645,727 and 1,320,085 shares, of its common stock at an average price of $15.55 and $15.20 per share, respectively. Accordingly, we have reduced common stock by the par value of such shares and have deducted the remaining excess repurchase price over par value from additional paid-in capital.

Since inception of the program and through the first half of fiscal 2008, the Company repurchased and retired approximately $78 million, or 3,793,304 shares, of its common stock at an average price of $20.44 per share. Accordingly, we have reduced common stock by the par value of such shares and have deducted the remaining excess repurchase price over par value from additional paid-in capital.

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

During the second quarter and first half of fiscal 2008, the Company issued 43,386 shares of common stock at a fair market value of $14.48 to its non-management board members. Accordingly, we recognized $630,000 in stock-based compensation expense. We received no proceeds from the issuance of these shares.

During the second quarter and first half of fiscal 2007, the Company issued 21,420 shares of common stock at a fair market value of $25.21 to its non-management board members. Accordingly, we recognized $540,000 in stock-based compensation expense. We received no proceeds from the issuance of these shares.

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

NOTE 8 – STOCK-BASED COMPENSATION:

We account for stock-based compensation expense in accordance with SFAS No. 123 (revised 2004), "Share-Based Payment." The fair value of time-based or performance-based stock option grants are estimated on the date of grant using the Black-Scholes option pricing method with the following weighted-average assumptions used for grants issued during the six-month period ended June 28, 2008.

	For the six-month period ended June 28, 2008
Volatility	35.95%
Risk-free interest rate	3.30%
Expected term (years)	6.0
Dividend yield	--

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

The following table summarizes our stock option and restricted stock activity during the six-month period ended June 28, 2008:

	Time-based stock options	Performance-based stock options	Retained stock options	Restricted stock
Outstanding, December 29, 2007	4,315,689	620,000	661,870	372,283
Granted	37,250	--	--	25,106
Exercised	(16,070)	--	--	--
Vested restricted stock	--	--	--	(38,850)
Forfeited	(12,900)	--	--	(5,200)
Expired	(8,100)	--	--	--
Outstanding, June 28, 2008	4,315,869	620,000	661,870	353,339

Exercisable, June 28, 2008	3,571,163	400,000	661,870	--

As a result of the retirement of Frederick J. Rowan, II, Chief Executive Officer and Chairman of the Board of Directors, during the second quarter of fiscal 2008, the Company recognized approximately $2.2 million of stock-based compensation expense as a result of the accelerated vesting of 400,000 performance-based stock options (see Note 13, "Executive Retirement Charges").

During the three-month period ended June 28, 2008, we granted 22,000 time-based stock options with a weighted-average Black-Scholes fair value of $5.93 and a weighted-average exercise price of $14.48. In connection with these grants, we recognized approximately $4,100 in stock-based compensation expense.

During the six-month period ended June 28, 2008, we granted 37,250 time-based stock options with a weighted-average Black-Scholes fair value of $6.88 and a weighted-average exercise price of $16.99. In connection with these grants, we recognized approximately $14,000 in stock-based compensation expense.

During the three-month period ended June 28, 2008, we granted 11,000 shares of restricted stock to employees with a weighted-average fair value on the date of grant of $14.48. In connection with these grants, we recognized approximately $5,000 in stock-based compensation expense.

During the six-month period ended June 28, 2008, we granted 25,106 shares of restricted stock to employees and a director with a weighted-average fair value on the date of grant of $16.58. In connection with these grants, we recognized approximately $28,000 in stock-based compensation expense.

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

NOTE 8 – STOCK-BASED COMPENSATION: (Continued)

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

(dollars in thousands)	Time-based stock options	Restricted stock	Total
2008 (period from June 29 through January 3, 2009)	$ 1,735	$ 1,267	$ 3,002
2009	2,495	2,114	4,609
2010	1,257	1,473	2,730
2011	1,065	939	2,004
2012	122	93	215
Total	$ 6,674	$ 5,886	$ 12,560

NOTE 9 – SEGMENT INFORMATION:

We report segment information in accordance with the provisions of SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," which requires segment information to be disclosed based upon a "management approach." The management approach refers to the internal reporting that is used by management for making operating decisions and assessing the performance of our reportable segments.

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

NOTE 9 – SEGMENT INFORMATION: (Continued)

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

	For the three-month periods ended				For the six-month periods ended			
(dollars in thousands)	June 28, 2008	% of Total	June 30, 2007	% of Total	June 28, 2008	% of Total	June 30, 2007	% of Total
Net sales:								
Wholesale-Carter's	$ 94,322	31.3%	$ 93,294	32.4%	$ 212,154	33.6%	$ 205,947	33.9%
Wholesale-OshKosh	13,760	4.6%	10,227	3.6%	32,209	5.1%	35,220	5.8%
Retail-Carter's	92,656	30.7%	76,275	26.5%	179,058	28.4%	151,101	24.8%
Retail-OshKosh	49,883	16.5%	48,885	17.0%	94,248	14.9%	94,733	15.6%
Mass Channel-Carter's	51,054	16.9%	59,094	20.5%	113,978	18.0%	120,902	19.9%
Total net sales	$ 301,675	100.0%	$ 287,775	100.0%	$ 631,647	100.0%	$ 607,903	100.0%
Operating income (loss):		% of segment net sales		% of segment net sales		% of segment net sales		% of segment net sales
Wholesale-Carter's	$ 12,007	12.7%	$ 16,102	17.3%	$ 33,566	15.8%	$ 37,488	18.2%
Wholesale-OshKosh	(4,312)	(31.3)%	(2,947)	(28.8)%	(6,836)	(21.2)%	(3,634)	(10.3)%
OshKosh cost in excess of fair value of net assets acquired-impairment	--	--	(35,995)	(352.0)%	--	--	(35,995)	(102.2)%
Net Wholesale-OshKosh	(4,312)	(31.3)%	(38,942)	(380.8)%	(6,836)	(21.2)%	(39,629)	(112.5)%
Retail-Carter's	10,358	11.2%	5,727	7.5%	21,800	12.2%	13,636	9.0%
Retail-OshKosh	(2,646)	(5.3)%	(1,726)	(3.5)%	(9,379)	(10.0)%	(3,019)	(3.2)%
OshKosh cost in excess of fair value of net assets acquired-impairment	--	--	(106,891)	(218.7)%	--	--	(106,891)	(112.8)%
Net Retail-OshKosh	(2,646)	(5.3)%	(108,617)	(222.2)%	(9,379)	(10.0)%	(109,910)	(116.0)%

Mass Channel-Carter's	7,779	15.2%	8,794	14.9%	14,521	12.7%	17,145	14.2%
Mass Channel-OshKosh (a)	628	--	361	--	1,159	--	888	--
Segment operating income (loss)	23,814	7.9%	(116,575)	(40.5)%	54,831	8.7%	(80,382)	(13.2)%
Other reconciling items	(14,562) (b)	(4.8)%	(9,298) (c)	(3.2)%	(25,026) (b)	(4.0)%	(24,319) (d)	(4.0)%
OshKosh tradename impairment	--	--	(12,000)	(4.2)%	--	--	(12,000)	(2.0)%
Net other reconciling items	(14,562)	(4.8)%	(21,298)	(7.4)%	(25,026)	(4.0)%	(36,319)	(6.0)%
Total operating income (loss)	$ 9,252	3.1%	$ (137,873)	(47.9)%	$ 29,805	4.7%	$ (116,701)	(19.2)%

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

(b) Includes $5.3 million in executive retirement charges in connection with Mr. Rowan's retirement (see Note 13).

(c) Includes $1.1 million in closure costs related to the closure of our OshKosh distribution center, including $0.6 million in accelerated depreciation.

(d) Includes $7.1 million in closure costs related to the closure of our OshKosh distribution center, including $2.1 million in accelerated depreciation.

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

NOTE 10 – FACILITY CLOSURE AND RESTRUCTURING COSTS:

OshKosh Distribution Facility

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

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," under a held and used model, it was determined that the distribution facility assets were impaired as of the end of January 2007, as it became "more likely than not" that the expected life of the OshKosh distribution facility would be significantly shortened. Accordingly, we wrote down the assets to their estimated recoverable fair value as of the end of January 2007. The adjusted asset values were subject to accelerated depreciation over their remaining estimated useful life. Distribution operations at the OshKosh facility ceased as of April 5, 2007, at which point the land, building, and equipment assets of $6.1 million were reclassified as held for sale. The Company continues to offer this vacant facility for sale and believes that the fair market value of this facility is equal to its carrying value.

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

Acquisition Restructuring

In connection with the Acquisition, management developed a plan to restructure and integrate the operations of OshKosh. In accordance with EITF No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination," liabilities were established for OshKosh severance, lease termination costs associated with the closure of 30 OshKosh retail stores, contract termination costs, and other exit and facility closure costs.

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

(dollars in thousands)	Severance and other exit costs	Lease termination costs	Total
Balance at December 29, 2007	$ 489	$ 674	$ 1,163
Payments	(458)	--	(458)
Balance at March 29, 2008	31	674	705
Payments	(53)	--	(53)
Adjustments	42	(42)	--
Balance at June 28, 2008	$ 20	$ 632	$ 652

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

NOTE 11 – EARNINGS PER SHARE:

Basic net income (loss) per share is calculated by dividing net income (loss) for the period by the weighted-average common shares outstanding for the period. Diluted net income (loss) per share includes the effect of dilutive instruments, such as stock options and restricted stock, and uses the average share price for the period in determining the number of shares that are to be added to the weighted-average number of shares outstanding. The following table summarizes the shares from these potentially dilutive securities, calculated using the treasury stock method:

(dollars in thousands, except per share data)	For the three-month periods ended June 28, 2008	For the three-month periods ended June 30, 2007	For the six-month periods ended June 28, 2008	For the six-month periods ended June 30, 2007
Net income (loss)	$ 2,779	$ (143,449)	$ 14,338	$ (133,838)
Weighted-average number of common and common equivalent shares outstanding:				
Basic number of common shares outstanding	56,156,795	57,838,075	56,685,914	58,142,782
Dilutive effect of unvested restricted stock	67,533	--	72,352	--
Dilutive effect of stock options	1,939,377	--	1,983,387	--
Diluted number of common and common equivalent shares outstanding	58,163,705	57,838,075	58,741,653	58,142,782
Basic net income (loss) per common share	$ 0.05	$ (2.48)	$ 0.25	$ (2.30)
Diluted net income (loss) per common share	$ 0.05	$ (2.48)	$ 0.24	$ (2.30)

For the three and six-month periods ended June 28, 2008, anti-dilutive shares of 1,052,135 and 991,385, respectively, and performance-based stock options of 620,000, were excluded from the computations of diluted earnings per share. For the three and six-month periods ended June 30, 2007, diluted net loss per common share is the same as basic net loss per common share, as the Company had a net loss.

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

NOTE 12 – RECENT ACCOUNTING PRONOUNCEMENTS:

In February 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. FAS 157-2 ("FSP 157-2"), which delays the effective date of SFAS 157, "Fair Value Measurements," for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Nonfinancial assets and nonfinancial liabilities would include all assets and liabilities other than those meeting the definition of a financial asset or financial liability as defined in paragraph 6 of SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This FSP defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP 157-2. We have evaluated the impact that FSP 157-2 will have on our consolidated financial statements and have determined that it will not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141(R)"), which replaces SFAS 141, "Business Combinations." SFAS 141(R) retains the underlying concepts of SFAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but SFAS 141(R) changed the method of applying the acquisition method in a number of significant aspects. Acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008. SFAS 141(R) amends SFAS No. 109, "Accounting for Income Taxes," such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS 141(R) would also apply the provisions of SFAS 141(R). Early adoption is not permitted. We are currently evaluating the effects, if any, that SFAS 141(R) may have on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133," which requires enhanced disclosures on the effect of derivatives on a Company's financial statements. These disclosures will be required for the Company beginning with the first quarter fiscal 2009 consolidated financial statements.

In April 2008, the FASB issued FSP No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). The FSP amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS 142. The FSP must be applied prospectively to intangible assets acquired after January 1, 2009. We are currently evaluating the impact that FSP 142-3 will have on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." This statement will not have an impact on the Company's consolidated financial statements.

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

NOTE 13 – EXECUTIVE RETIREMENT CHARGES:

On June 11, 2008, the Company announced the retirement of Frederick J. Rowan, II, Chairman of the Board of Directors and Chief Executive Officer, effective August 1, 2008. In connection with his retirement, the Company recorded charges during the second quarter of fiscal 2008 of $5.3 million, $3.1 million of which relates to the present value of severance and benefit obligations, and $2.2 million relates to the accelerated vesting of Mr. Rowan's performance-based stock options.

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

The following is a discussion of our results of operations and current financial position. You should read this discussion in conjunction with our unaudited condensed consolidated financial statements and the accompanying notes included elsewhere in this quarterly report.

Our fiscal year ends on the Saturday, in December or January, nearest the last day of December. The accompanying unaudited condensed consolidated financial statements for the second quarter and first half of fiscal 2008 reflect our financial position as of June 28, 2008. The second quarter and first half of fiscal 2007 ended on June 30, 2007.

RESULTS OF OPERATIONS

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

	Three-month periods ended		Six-month periods ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Wholesale sales:				
Carter's	31.3%	32.4%	33.6%	33.9%
OshKosh	4.6	3.6	5.1	5.8
Total wholesale sales	35.9	36.0	38.7	39.7
Retail store sales:				
Carter's	30.7	26.5	28.4	24.8
OshKosh	16.5	17.0	14.9	15.6
Total retail store sales	47.2	43.5	43.3	40.4
Mass channel sales	16.9	20.5	18.0	19.9
Consolidated net sales	100.0	100.0	100.0	100.0
Cost of goods sold	67.0	66.8	67.6	66.8
Gross profit	33.0	33.2	32.4	33.2
Selling, general, and administrative expenses	30.6	29.4	29.2	28.4
Intangible asset impairment	--	53.8	--	25.5
Executive retirement charges	1.7	--	0.9	--
Closure costs	--	0.2	--	0.8
Royalty income	(2.4)	(2.3)	(2.4)	(2.3)
Operating income (loss)	3.1	(47.9)	4.7	(19.2)
Interest expense, net	1.6	2.0	1.5	1.9
Income (loss) before income taxes	1.5	(49.9)	3.2	(21.1)

Provision for (benefit from) income taxes	0.6	(0.1)	0.9	0.9
Net income (loss)	0.9%	(49.8)%	2.3%	(22.0)%
Number of retail stores at end of period:				
Carter’s	231	221	231	221
OshKosh	163	159	163	159
Total	394	380	394	380

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

Three and six-month periods ended June 28, 2008 compared to the three and six-month periods ended June 30, 2007

CONSOLIDATED NET SALES

In the second quarter of fiscal 2008, consolidated net sales increased $13.9 million, or 4.8%, to $301.7 million and reflects sales growth in our Carter's brand retail and wholesale segments and our OshKosh brand segments, partially offset by a decline in net sales in our mass channel segment. In the first half of fiscal 2008, consolidated net sales increased $23.7 million, or 3.9%, to $631.6 million and reflects growth in our Carter's brand retail and wholesale segments, partially offset by a decline in our mass channel segment and our OshKosh brand segments.

	For the three-month periods ended				For the six-month periods ended			
(dollars in thousands)	June 28, 2008	% of Total	June 30, 2007	% of Total	June 28, 2008	% of Total	June 30, 2007	% of Total
Net sales:								
Wholesale-Carter's	$ 94,322	31.3%	$ 93,294	32.4%	$ 212,154	33.6%	$ 205,947	33.9%
Wholesale-OshKosh	13,760	4.6%	10,227	3.6%	32,209	5.1%	35,220	5.8%
Retail-Carter's	92,656	30.7%	76,275	26.5%	179,058	28.4%	151,101	24.8%
Retail-OshKosh	49,883	16.5%	48,885	17.0%	94,248	14.9%	94,733	15.6%
Mass Channel-Carter's	51,054	16.9%	59,094	20.5%	113,978	18.0%	120,902	19.9%
Total net sales	$ 301,675	100.0%	$ 287,775	100.0%	$ 631,647	100.0%	$ 607,903	100.0%

CARTER'S WHOLESALE SALES

Carter's brand wholesale sales increased $1.0 million, or 1.1%, in the second quarter of fiscal 2008 to $94.3 million and was driven by an 11% increase in units shipped, partially offset by a 9% decline in average price per unit as compared to the second quarter of fiscal 2007.

Carter's brand wholesale sales increased $6.2 million, or 3.0%, in the first half of fiscal 2008 to $212.2 million and was driven by an 11% increase in units shipped, partially offset by a 7% decline in average price per unit as compared to the first half of fiscal 2007.

The increase in units shipped during the second quarter and first half of fiscal 2008 was driven by increased shipments of our baby and playwear products, due primarily to the timing of demand and higher levels of off-price sales, partially offset by a decrease in sleepwear units shipped. The decrease in average price per unit during the second quarter and first half of fiscal 2008 was due to more competitive pricing in our baby, playwear, and sleepwear product categories.

OSHKOSH WHOLESALE SALES

OshKosh brand wholesale sales increased $3.5 million, or 34.5%, in the second quarter of fiscal 2008 to $13.8 million, primarily due to a substantial increase in the amount of off-price shipments. In addition, the increase in OshKosh brand wholesale sales reflects a 79% increase in units shipped, partially offset by a 25% decrease in average price per unit as compared to the second quarter of fiscal 2007. The decrease in average price per unit reflects lower average selling prices on off-price units, in addition to the change in strategy to reposition the OshKosh brand to appeal to a broader audience of mainstream consumers.

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

OshKosh brand wholesale sales decreased $3.0 million, or 8.5%, in the first half of fiscal 2008 to $32.2 million. The decrease in OshKosh brand wholesale sales reflects a 26% decrease in average price per unit due to the change in strategy to reposition the brand, as well as lower average selling prices on off-price units. This decrease was partially offset by a 23% increase in units shipped as compared to the first half of fiscal 2007, including increases in both seasonal shipments and off-price units.

The lower average price per unit reflects a change in strategy to reposition the OshKosh brand. We believe we have strengthened the OshKosh brand to be more competitive in the marketplace and enhance the profitability of our customers. The benefits from this change in strategy are not expected to meaningfully improve our OshKosh brand sales and related profitability until the cumulative effect of changes in talent, product benefits, pricing, branding, and sourcing strategies are reflected in our Spring 2009 product line. Our Spring 2009 product line begins shipping in the latter part of the fourth quarter of fiscal 2008.

MASS CHANNEL SALES

Mass channel sales decreased $8.0 million, or 13.6%, in the second quarter of fiscal 2008 to $51.1 million. The decrease was due to an $8.5 million, or 22.2%, decrease in sales of our Child of Mine brand to Wal-Mart, partially offset by a $0.5 million, or 2.3%, increase in sales of our Just One Year brand to Target. The decrease in Child of Mine sales was due to the performance of certain Spring 2008 products. We believe we have strengthened the underperforming Child of Mine product categories for Fall 2008 which is planned up 4% as compared to Fall 2007. Fall 2008 began shipping in June 2008. The increase in Just One Year sales was driven primarily from new door growth, partially offset by product performance.

Mass channel sales decreased $6.9 million, or 5.7%, in the first half of fiscal 2008 to $114.0 million. The decrease was due to a $12.2 million, or 15.7%, decrease in sales of our Child of Mine brand to Wal-Mart, partially offset by a $5.3 million, or 12.1%, increase in sales of our Just One Year brand to Target. The decrease in Child of Mine sales was due to the performance of certain Spring 2008 products. The increase in Just One Year sales was driven primarily from new door growth.

CARTER’S RETAIL STORES SALES

Carter’s retail store sales increased $16.4 million, or 21.5%, in the second quarter of fiscal 2008 to $92.7 million. The increase was driven by a comparable store sales increase of $13.2 million, or 17.3%, and incremental sales of $3.5 million generated by new store openings, partially offset by the impact of store closures of $0.2 million. On a comparable store basis, transactions increased 10.4%, units per transaction increased 5.2%, and average prices increased 1.1%. These increases in transactions, units per transaction, and average prices were driven by strong product performance in all categories, particularly in baby and playwear, higher inventory levels, and better product mix. We also believe that better in-store product presentation and a focus on improving customer service levels contributed to the increase. Average inventory per door increased 5.2% over the second quarter of fiscal 2007.

In the first half of fiscal 2008, Carter’s retail store sales increased $28.0 million, or 18.5%, to $179.1 million. The increase was driven by a comparable store sales increase of $22.3 million, or 14.9%, and incremental sales of $6.2 million generated by new store openings, partially offset by the impact of store closures of $0.5 million. On a comparable store basis, transactions increased 7.3%, units per transaction increased 6.3%, and average prices increased 0.8%. These increases in transactions, units per transaction, and average prices were driven by strong product performance in all categories, particularly in baby and playwear, higher inventory levels, and better product mix. We also believe that better in-store product presentation and a focus on improving customer service levels contributed to the increase. Average inventory per door increased 12.4% over the first half of fiscal 2007.

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

The Company's comparable store sales calculations include sales for all stores that were open during the comparable fiscal period, including remodeled stores and certain relocated stores. If a store relocates within the same center with no business interruption or material change in square footage, the sales for such store will continue to be included in the comparable store calculation. If a store relocates to another center, or there is a material change in square footage, the store is treated as a new store. Stores that are closed during the period are included in the comparable store sales calculation up to the date of closing.

There were a total of 231 Carter's retail stores as of June 28, 2008. During the second quarter of fiscal 2008, we opened two stores. During the first half of fiscal 2008, we opened three Carter's retail stores. In total, we plan to open 25 and close five Carter's retail stores during fiscal 2008.

OSHKOSH RETAIL STORES SALES

OshKosh retail store sales increased $1.0 million, or 2.0%, in the second quarter of fiscal 2008 to $49.9 million. The increase was driven by incremental sales of $1.8 million generated by new store openings, partially offset by a comparable store sales decrease of 0.9%, or $0.4 million, and the impact of store closures of $0.4 million. On a comparable store basis, units per transaction increased 11.3%, and average prices decreased 10.7%. The decrease in average prices and increase in units per transaction were driven by heavy promotional pricing on excess 2007 Fall and Holiday product. Average inventory per door was down 7.3% as compared to the second quarter of fiscal 2007.

OshKosh retail store sales decreased $0.5 million, or 0.5%, in the first half of fiscal 2008 to $94.2 million. The decrease was due to a comparable store sales decrease of $3.4 million, or 3.7%, and the impact of store closures of $0.8 million, partially offset by incremental sales of $3.7 million generated by new store openings. On a comparable store basis, average prices decreased 14.7%, and units per transaction increased 13.6%. The decrease in average prices and increase in units per transaction were driven by heavy promotional pricing on excess products in our 2007 Fall and Holiday product lines. Average inventory per door was up 4.2% as compared to the first half of fiscal 2007.

There were a total of 163 OshKosh retail stores as of June 28, 2008. In total, we plan to open two and close three OshKosh retail stores during fiscal 2008.

GROSS PROFIT

Our gross profit increased $4.2 million, or 4.4%, to $99.6 million in the second quarter of fiscal 2008. Gross profit as a percentage of net sales was 33.0% in the second quarter of fiscal 2008 as compared to 33.2% in the second quarter of fiscal 2007. Our gross profit increased $2.7 million, or 1.3%, to $204.5 million in the first half of fiscal 2008. Gross profit as a percentage of net sales was 32.4% in the first half of fiscal 2008 as compared to 33.2% in the first half of fiscal 2007.

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

(i) Higher provisions for excess inventory of approximately $1.0 million in the second quarter of fiscal 2008 and $6.5 million in the first half of fiscal 2008, particularly related to our OshKosh retail and Carter's wholesale and mass channel segments;

(ii) A decline in OshKosh brand wholesale and retail margins due to price reductions and product performance; and

(iii) Lower margins on certain Spring 2008 Child of Mine products due to disappointing over-the-counter performance.

These decreases were partially offset by growth in our higher margin Carter's retail business for the second quarter and first half of fiscal 2008.

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

The Company includes distribution costs in its selling, general, and administrative expenses. Accordingly, the Company's gross profit may not be comparable to other companies that include such distribution costs in their cost of goods sold.

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES

Selling, general, and administrative expenses in the second quarter of fiscal 2008 increased $7.6 million, or 8.9%, to $92.2 million. As a percentage of net sales, selling, general, and administrative expenses in the second quarter of fiscal 2008 were 30.6% as compared to 29.4% in the second quarter of fiscal 2007. Selling, general, and administrative expenses in the first half of fiscal 2008 increased $11.6 million, or 6.7%, to $184.5 million. As a percentage of net sales, selling, general, and administrative expenses in the first half of fiscal 2008 were 29.2% as compared to 28.4% in the first half of fiscal 2007.

The increases in selling, general, and administrative expenses as a percentage of net sales reflect:

(i) growth in our consolidated retail store expenses related primarily to new store openings and investments in our retail management team; and

(ii) a provision for incentive compensation of $1.8 million in the second quarter of fiscal 2008 and $1.4 million in the first half of fiscal 2008 as compared to the second quarter and first half of fiscal 2007, respectively.

Partially offsetting these increases was:

(i) favorable distribution and freight costs in the second quarter and first half of fiscal 2008 compared to the second quarter and first half of fiscal 2007 resulting from supply chain efficiencies; and

(ii) accelerated depreciation charges of $0.6 million and $2.1 million that the Company recorded in the second quarter and first half of fiscal 2007 in connection with the closure of our OshKosh distribution center.

INTANGIBLE ASSET IMPAIRMENT

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

EXECUTIVE RETIREMENT CHARGES

On June 11, 2008, the Company announced the retirement of Frederick J. Rowan, II, Chairman of the Board of Directors and Chief Executive Officer, effective August 1, 2008. In connection with his retirement, the Company recorded charges during the second quarter of fiscal 2008 of $5.3 million, $3.1 million of which relates to the present value of severance and benefit obligations, and $2.2 million relates to the accelerated vesting of Mr. Rowan's performance stock options.

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

CLOSURE COSTS

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

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

ROYALTY INCOME

We license the use of our Carter’s, Just One Year, Child of Mine, OshKosh B’Gosh, OshKosh, and Genuine Kids from OshKosh brand names. Royalty income from these brands was approximately $7.2 million (including $1.6 million of international royalty income from our OshKosh brands) in the second quarter of fiscal 2008, an increase of 7.5%, or $0.5 million, as compared to the second quarter of fiscal 2007. This increase was driven primarily by Carter’s, Genuine Kids from OshKosh, and Child of Mine brand domestic licensee sales. Growth in our Carter’s licensing business was, in part, driven by the launch of our new licensed furniture business.

Royalty income from these brands was approximately $15.1 million (including $3.4 million of international royalty income from our OshKosh brands) in the first half of fiscal 2008, an increase of 6.1%, or $0.9 million, as compared to the first half of fiscal 2007. This increase was driven primarily by Carter’s, Child of Mine, and OshKosh brand domestic licensee sales.

OPERATING INCOME (LOSS)

Our operating income was $9.3 million in the second quarter of fiscal 2008 as compared to an operating loss of $137.9 million in the second quarter of fiscal 2007. Our operating income was $29.8 million in the first half of fiscal 2008 as compared to an operating loss of $116.7 million in the first half of fiscal 2007. These increases in operating results are due to the factors described above.

INTEREST EXPENSE, NET

Interest expense in the second quarter of fiscal 2008 decreased $0.9 million, or 16.0%, to $4.8 million. The decrease is primarily attributable to lower effective interest rates. Weighted-average borrowings in the second quarter of fiscal 2008 were $340.7 million at an effective interest rate of 6.21% as compared to weighted-average borrowings in the second quarter of fiscal 2007 of $343.9 million at an effective interest rate of 7.13%. In the second quarter of fiscal 2008, we recorded $0.5 million in interest expense related to our interest rate swap agreement and $0.5 million in interest expense related to our interest rate collar agreement. In the second quarter of fiscal 2007, we recorded interest income of approximately $0.4 million related to our interest rate swap agreement, which effectively reduced our interest expense under the term loan.

Interest expense in the first half of fiscal 2008 decreased $2.1 million, or 18.6%, to $9.3 million. The decrease is primarily attributable to lower effective interest rates on lower weighted-average borrowings. Weighted-average borrowings in the first half of fiscal 2008 were $341.1 million at an effective interest rate of 6.01% as compared to weighted-average borrowings in the first half of fiscal 2007 of $344.3 million at an effective interest rate of 7.17%. In the first half of fiscal 2008, we recorded $0.6 million in interest expense related to our interest rate swap agreement and $0.5 million in interest expense related to our interest rate collar agreement. In the first half of fiscal 2007, we recorded interest income of approximately $0.9 million related to our interest rate swap agreement, which effectively reduced our interest expense under the term loan.

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

INCOME TAXES

Our effective tax rate was 37.7% for the second quarter of fiscal 2008, 0.1% for the second quarter of fiscal 2007, 30.0% for the first half of fiscal 2008, and 4.5% for the first half of fiscal 2007. The decrease in the effective tax rate for the first half of fiscal 2008 as compared to the second quarter of fiscal 2008 was due to the reversal of $1.6 million of reserves for certain tax exposures in the first quarter of fiscal 2008 following the completion of an Internal Revenue Service examination. The 0.1% benefit against our pre-tax loss for the second quarter of fiscal 2007 and the 4.5% effective tax rate for the first half of fiscal 2007 was a result of the impairment of our OshKosh cost in excess of fair value of net assets acquired asset which is not deductible for income tax purposes.

NET INCOME (LOSS)

As a result of the factors above, our net income for the second quarter of fiscal 2008 was $2.8 million as compared to a net loss of $143.4 million in the second quarter of fiscal 2007. Our net income for the first half of fiscal 2008 was $14.3 million as compared to a net loss of $133.8 million for the first half of fiscal 2007.

FINANCIAL CONDITION, CAPITAL RESOURCES, AND LIQUIDITY

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

Net accounts receivable at June 28, 2008 were $102.6 million compared to $104.5 million at June 30, 2007 and $119.7 million at December 29, 2007. The decrease as compared to June 30, 2007 reflects timing of customer payments. Due to the seasonal nature of our operations, the net accounts receivable balance at June 28, 2008 is not comparable to the net accounts receivable balance at December 29, 2007.

Net inventories at June 28, 2008 were $250.8 million compared to $231.6 million at June 30, 2007 and $225.5 million at December 29, 2007. The increase of $19.2 million, or 8.3%, as compared to June 30, 2007 is due primarily to bringing inventory in earlier to reduce exposure to a potential West Coast port strike and timing of mass channel shipments. Due to the seasonal nature of our operations, net inventories at June 28, 2008 are not comparable to net inventories at December 29, 2007.

Net cash provided by operating activities for the first half of fiscal 2008 was $24.1 million compared to net cash used in operating activities of $8.3 million in the first half of fiscal 2007. The increase in operating cash flow reflects favorable changes in working capital.

We invested $7.1 million in capital expenditures during the first half of fiscal 2008 compared to $7.7 million during the first half of fiscal 2007. We plan to invest approximately $43 million in capital expenditures during the remainder of fiscal 2008 primarily for retail store openings, a new point of sale system for our retail stores, and fixtures for our wholesale customers.

On February 16, 2007, the Company’s Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to $100 million of its outstanding common shares. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by management, based on its evaluation of market conditions, share price, and other factors. During the second quarter and first half of fiscal 2008, the Company repurchased and retired approximately $10 million and $20 million, or 645,727 and 1,320,085 shares, of its common stock at an average price $15.55 and $15.20 per share, respectively. Since inception of the program and through the six-month period ended June 28, 2008, the Company repurchased and retired approximately $78 million, or 3,793,304 shares, of its common stock at an average price of $20.44 per share.

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

At June 28, 2008, we had approximately $340.7 million in term loan borrowings and no borrowings outstanding under our revolver, exclusive of approximately $9.1 million of outstanding letters of credit. Principal borrowings under our term loan are due and payable in quarterly installments of $0.9 million through June 30, 2012 with the remaining balance of $325.8 million due on July 14, 2012.

Our senior credit facility requires us to hedge at least 25% of our variable rate debt under the term loan. On September 22, 2005, we entered into an interest rate swap agreement to receive floating interest and pay fixed interest. This interest rate swap agreement is designated as a cash flow hedge of the variable interest payments on a portion of our variable rate term loan debt. The fair market value of the interest rate swap agreement as of June 28, 2008 was a liability of $1.2 million and is included in other current liabilities in the accompanying unaudited condensed consolidated balance sheet. The interest rate swap agreement matures on July 30, 2010. As of June 28, 2008, approximately $139.7 million of our outstanding term loan debt was hedged under this agreement.

On May 25, 2006, we entered into an interest rate collar agreement with a floor of 4.3% and a ceiling of 5.5%. The fair market value of the interest rate collar agreement as of June 28, 2008 was a liability of $1.0 million and is included in other current liabilities in the accompanying unaudited condensed consolidated balance sheet. The interest rate collar agreement covers $100 million of our variable rate term loan debt and is designated as a cash flow hedge of the variable interest payments on such debt. The interest rate collar agreement matures on January 31, 2009.

Our operating results are subject to risk from interest rate fluctuations on our senior credit facility, which carries variable interest rates. As of June 28, 2008, $101.0 million of our outstanding debt bore interest at a variable rate. An increase or decrease of 1% in the applicable rate would increase or decrease our annual interest cost by $1.0 million, exclusive of variable rate debt subject to our interest rate swap and collar agreements, and could have an adverse effect on our earnings and cash flow.

Our senior credit facility also sets forth mandatory and optional prepayment conditions, including an annual excess cash flow requirement, as defined, that may result in our use of cash to reduce our debt obligations. No such prepayment was required for fiscal 2007 or 2006.

As a result of the closure of the OshKosh distribution facility, we recorded closure costs in the first half of fiscal 2007 of $7.1 million, consisting of asset impairment charges of $2.4 million related to a write-down of the related land, building, and equipment; $2.0 million of severance charges; $2.1 million of accelerated depreciation (included in selling, general, and administrative expenses); and $0.6 million of other closure costs. The estimated value of the OshKosh distribution facility assets as of June 28, 2008 was $6.1 million and are classified as assets held for sale. The Company continues to offer this vacant facility for sale and believes that the fair market value of this facility is equal to its carrying value.

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

(dollars in thousands)	Severance and other exit	Lease termination costs	Total

costs

Balance at December 29, 2007	$	489	$	674	$	1,163
Payments		(458)		--		(458)
Balance at March 29, 2008		31		674		705
Payments		(53)		--		(53)
Adjustments		42		(42)		--
Balance at June 28, 2008	$	20	$	632	$	652

27

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

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

EFFECTS OF INFLATION AND DEFLATION

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

SEASONALITY

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

Revenue recognition: We recognize wholesale and mass channel revenue after shipment of products to customers, when title passes, when all risks and rewards of ownership have transferred, the sales price is fixed or determinable, and collectibility is reasonably assured. In certain cases, in which we retain the risk of loss during shipment, revenue recognition does not occur until the goods have reached the specified customer. In the normal course of business, we grant certain accommodations and allowances to our wholesale and mass channel customers in order to assist these customers with inventory clearance and promotions. Such amounts are reflected as a reduction of net sales and are recorded based upon historical trends and annual forecasts. Retail store revenues are recognized at the point of sale. We reduce revenue for customer returns and deductions. We also maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make payments and other actual and estimated deductions. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required. Past due balances over 90 days are reviewed individually for collectibility. Our credit and collections department reviews all other balances regularly. Account balances are charged off against the allowance when we feel it is probable the receivable will not be recovered.

We contract with a third-party service to provide us with the fair value of cooperative advertising arrangements entered into with certain of our major wholesale and mass channel customers. Such fair value is determined based upon, among other factors, comparable market analysis for similar advertisements. In accordance with Emerging Issues Task Force Issue No. 01-09, “Accounting for Consideration Given by a Vendor to a Customer/Reseller,” we have included the fair value of these arrangements of approximately $0.2 million and $0.9 million in the second quarter and the first half of fiscal 2008 and $0.1 million and $0.6 million in the second quarter and first half of fiscal 2007 as a component of selling, general, and administrative expenses in the accompanying unaudited condensed consolidated statements of operations rather than as a reduction of revenue. Amounts determined to be in excess of the fair value of these arrangements are recorded as a reduction of net sales.

Inventory: We provide reserves for slow-moving inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we project, additional write-downs may be required.

Cost in excess of fair value of net assets acquired and tradename: As of June 28, 2008, we had approximately $443.3 million in Carter’s cost in excess of fair value of net assets acquired and Carter’s and OshKosh tradename assets. The fair value of the Carter’s tradename was estimated at the 2001 acquisition to be approximately $220.2 million using a discounted cash flow analysis, which examined the hypothetical cost savings that accrue as a result of our ownership of the tradename. The fair value of the OshKosh tradename was estimated to be approximately $88.0 million, also using a discounted cash flow analysis. The cash flows, which incorporated both historical and projected financial performance, were discounted using a discount rate of 10% for Carter’s and 12% for OshKosh. The tradenames were determined to have indefinite lives. The carrying values of these assets are subject to annual impairment reviews as of the last day of each fiscal year. Factors affecting such impairment reviews include the continued market acceptance of our offered products and the development of new products. Impairment reviews may also be triggered by any significant events or changes in circumstances.

Accrued expenses: Accrued expenses for workers’ compensation, incentive compensation, health insurance, and other outstanding obligations are assessed based on actual commitments, statistical trends, and estimates based on projections and current expectations, and these estimates are updated periodically as additional information becomes available.

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

Accounting for income taxes: As part of the process of preparing the accompanying unaudited condensed consolidated financial statements, we are required to estimate our actual current tax exposure (state, federal, and foreign). We assess our income tax positions and record tax benefits for all years subject to examination based upon management’s evaluation of the facts, circumstances, and information available at the reporting dates. For those uncertain tax positions where it is “more likely than not” that a tax benefit will be sustained, we have recorded the largest amount of tax benefit with a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not “more likely than not” that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Where applicable, associated interest is also recognized. We also assess permanent and temporary differences resulting from differing bases and treatment of items for tax and accounting purposes, such as the carrying value of intangibles, deductibility of expenses, depreciation of property, plant, and equipment, and valuation of inventories. Temporary differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income. Actual results could differ from this assessment if sufficient taxable income is not generated in future periods. To the extent we determine the need to establish a valuation allowance or increase such allowance in a period, we must include an expense within the tax provision in the accompanying unaudited condensed consolidated statement of operations.

Stock-based compensation arrangements: The Company accounts for stock-based compensation in accordance with the fair value recognition provisions of SFAS No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”). The Company adopted SFAS 123R using the modified prospective application method of transition. The Company uses the Black-Scholes option pricing model, which requires the use of subjective assumptions. These assumptions include the following:

Volatility – This is a measure of the amount by which a stock price has fluctuated or is expected to fluctuate. The Company uses actual monthly historical changes in the market value of our stock since the Company’s initial public offering on October 29, 2003, supplemented by peer company data for periods prior to our initial public offering covering the expected life of stock options being valued. An increase in the expected volatility will increase compensation expense.

Risk-free interest rate – This is the U.S. Treasury rate as of the grant date having a term equal to the expected term of the stock option. An increase in the risk-free interest rate will increase compensation expense.

Expected term – This is the period of time over which the stock options granted are expected to remain outstanding and is based on historical experience and estimated future exercise behavior. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. An increase in the expected term will increase compensation expense.

Dividend yield – The Company does not have plans to pay dividends in the foreseeable future. An increase in the dividend yield will decrease compensation expense.

Forfeitures – The Company estimates forfeitures of stock-based awards based on historical experience and expected future activity.

Changes in the subjective assumptions can materially affect the estimate of fair value of stock–based compensation and consequently, the related amount recognized in the accompanying unaudited condensed consolidated statements of operations.

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

The Company accounts for its performance-based awards in accordance with SFAS 123R and records stock-based compensation expense over the vesting term of the awards that are expected to vest based on whether it is probable that the performance criteria will be achieved. The Company reassesses the probability of vesting at each reporting period for awards with performance criteria and adjusts stock-based compensation expense based on its probability assessment.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2008, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position (“FSP”) No. FAS 157-2 (“FSP 157-2”), which delays the effective date of SFAS 157, "Fair Value Measurements," for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Nonfinancial assets and nonfinancial liabilities would include all assets and liabilities other than those meeting the definition of a financial asset or financial liability as defined in paragraph 6 of SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities.” This FSP defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP 157-2. We have evaluated the impact that FSP 157-2 will have on our consolidated financial statements and have determined that it will not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), “Business Combinations” (“SFAS 141(R)”), which replaces SFAS 141, “Business Combinations.” SFAS 141(R) retains the underlying concepts of SFAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but SFAS 141(R) changed the method of applying the acquisition method in a number of significant aspects. Acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008. SFAS 141(R) amends SFAS No. 109, “Accounting for Income Taxes,” such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS 141(R) would also apply the provisions of SFAS 141(R). Early adoption is not permitted. We are currently evaluating the effects, if any, that SFAS 141(R) may have on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133,” which requires enhanced disclosures on the effect of derivatives on a Company’s financial statements. These disclosures will be required for the Company beginning with the first quarter fiscal 2009 consolidated financial statements.

In April 2008, the FASB issued FSP No. 142-3, “Determination of the Useful Life of Intangible Assets” (“FSP 142-3”). The FSP amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under SFAS No. 142, “Goodwill and Other Intangible Assets.” The FSP must be applied prospectively to intangible assets acquired after January 1, 2009. We are currently evaluating the impact that FSP 142-3 will have on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (“SFAS 162”). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 is effective 60 days following the Securities and Exchange Commission’s approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.” This statement will not have an impact on the Company’s consolidated financial statements.

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

FORWARD-LOOKING STATEMENTS

Statements contained herein that relate to our future performance, including, without limitation, statements with respect to our anticipated results of operations or level of business for fiscal 2008 or any other future period, are forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on current expectations only and are subject to certain risks, uncertainties, and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. These risks are described herein under Item 1A of Part II. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

CURRENCY AND INTEREST RATE RISKS

In the operation of our business, we have market risk exposures including those related to foreign currency risk and interest rates. These risks and our strategies to manage our exposure to them are discussed below.

We contract for production with third parties primarily in the Far East and South and Central America. While these contracts are stated in United States dollars, there can be no assurance that the cost for the future production of our products will not be affected by exchange rate fluctuations between the United States dollar and the local currencies of these contractors. Due to the number of currencies involved, we cannot quantify the potential impact of future currency fluctuations on net income (loss) in future years. In order to manage this risk, we source products from approximately 130 vendors worldwide, providing us with flexibility in our production should significant fluctuations occur between the United States dollar and various local currencies. To date, such exchange fluctuations have not had a material impact on our financial condition or results of operations. We do not hedge foreign currency exchange rate risk.

Our operating results are subject to risk from interest rate fluctuations on our senior credit facility, which carries variable interest rates. As of June 28, 2008, our outstanding debt aggregated $340.7 million, of which $101.0 million bore interest at a variable rate. An increase or decrease of 1% in the applicable rate would increase or decrease our annual interest cost by $1.0 million, exclusive of variable rate debt subject to our interest rate swap and collar agreements, and could have an adverse effect on our net income (loss) and cash flow.

OTHER RISKS

We enter into various purchase order commitments with full-package suppliers. We can cancel these arrangements, although in some instances, we may be subject to a termination charge reflecting a percentage of work performed prior to cancellation. As we rely exclusively on our full-package global sourcing network, we could incur more of these termination charges, which could increase our cost of goods sold and have a material impact on our business.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

N/A

ITEM 1A. RISK FACTORS

You should carefully consider each of the following risk factors as well as the other information contained in this Quarterly Report on Form 10-Q and other filings with the Securities and Exchange Commission in evaluating our business. The risks and uncertainties described below are not the only we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may also impact our business operations. If any of the following risks actually occur, our operating results may be affected.

Risks Relating to Our Business

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

In the second quarter and first half of fiscal 2008, we derived approximately 38% and 41% of our consolidated net sales from our top eight customers, including mass channel customers. Wal-Mart accounted for approximately 10% of our consolidated net sales for both the second quarter and first half of fiscal 2008. We expect that this customer will continue to represent a significant portion of our sales in the future. However, we do not enter into long-term sales contracts with our major customers, relying instead on long-standing relationships with these customers and on our position in the marketplace. As a result, we face the risk that one or more of our major customers may significantly decrease its or their business with us or terminate its or their relationships with us. Any such decrease or termination of our major customers' business could result in a material decrease in our sales and operating results.

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

We believe that continued success depends on our ability to provide a unique and compelling value proposition for our consumers in the Company’s distribution channels. There can be no assurance that the demand for our products will not decline, or that we will be able to successfully evaluate and adapt our product to be aware of consumers’ tastes and preferences and fashion trends. If consumers’ tastes and preferences are not aligned with our product offerings, promotional pricing may be required to move seasonal merchandise. Increased use of promotional pricing would have a material adverse affect on our sales, gross margin, and results of operations.

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

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

34

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

Database privacy, network security, and identity theft are matters of growing public concern. In an attempt to prevent unauthorized access to our network and databases containing confidential, third-party information, we have installed privacy protection systems, devices, and activity monitoring on our network. Nevertheless, if unauthorized parties gain access to our networks or databases, they may be able to steal, publish, delete, or modify our private and sensitive third-party information. In such circumstances, we could be held liable to our customers or other parties or be subject to regulatory or other actions for breaching privacy rules. This could result in costly investigations and litigation, civil or criminal penalties, and adverse publicity that could adversely affect our financial condition, results of operations, and reputation. Further, if we are unable to comply with the security standards, established by banks and the credit card industry, we may be subject to fines, restrictions, and expulsion from card acceptance programs, which could adversely affect our retail operations.

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

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

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

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

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

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

We source substantially all of our products through foreign production arrangements. Our dependence on foreign supply sources could result in disruptions to our operations in the event of political instability, unfavorable economic conditions, international events, or new foreign regulations and such disruptions may increase our cost of goods sold and decrease gross profit.

We source substantially all of our products through a network of vendors in the Far East, coordinated by our Far East agents. The following could disrupt our foreign supply chain, increase our cost of goods sold, decrease our gross profit, or impact our ability to get products to our customers:

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

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

We operate in a highly competitive market and the size and resources of some of our competitors may allow them to compete more effectively than we can, resulting in a loss of market share and, as a result, a decrease in revenues and gross profit.

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

- adapt to changes in customer requirements more quickly;
- take advantage of acquisition and other opportunities more readily;

- devote greater resources to the marketing and sale of their products; and
- adopt more aggressive pricing strategies than we can.

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

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

Our leverage could adversely affect our financial condition.

On June 28, 2008, we had total debt of approximately $340.7 million.

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

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

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

Profitability could be negatively impacted if we do not adequately forecast the demand for our products and, as a result, create significant levels of excess inventory or insufficient levels of inventory.

If the Company does not adequately forecast demand for its products and purchases inventory to support an inaccurate forecast, the Company could experience increased costs due to the need to dispose of excess inventory or lower profitability due to insufficient levels of inventory.

We may not achieve sales growth plans, cost savings, and other assumptions that support the carrying value of our intangible assets.

In connection with the 2001 acquisition of the Company, we recorded cost in excess of fair value of net assets acquired of $136.6 million and a Carter’s brand tradename asset of $220.2 million. Additionally, in connection with the acquisition of OshKosh, we recorded cost in excess of fair value of net assets acquired of $142.9 million and an OshKosh brand tradename asset of $102.0 million. The carrying value of these assets is subject to annual impairment reviews as of the last day of each fiscal year or more frequently, if deemed necessary, due to any significant events or changes in circumstances. During the second quarter of fiscal 2007, the Company performed an interim impairment review of the OshKosh intangible assets due to continued negative trends in sales and profitability of the Company’s OshKosh wholesale and retail segments. As a result of this review, the Company wrote off our OshKosh cost in excess of fair value of net assets acquired asset of $142.9 million and wrote down the OshKosh tradename by $12.0 million.

Estimated future cash flows used in these impairment reviews could be negatively impacted if we do not achieve our sales plans, planned cost savings, and other assumptions that support the carrying value of these intangible assets, which could result in potential impairment of the remaining asset value.

The Company’s success is dependent upon retaining key individuals within the organization to execute the Company’s strategic plan.

The Company’s ability to attract and retain qualified executive management, marketing, merchandising, design, sourcing, operations, and support function staffing is key to the Company’s success. If the Company were unable to attract and retain qualified individuals in these areas, an adverse impact on the Company’s growth and results of operations may result.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURTIES AND USE OF PROCEEDS

The following table provides information about purchases by the Company during the three-month period ended June 28, 2008, of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (2)	Approximate dollar value of shares that may yet be purchased under the plans or programs (2)
March 30, 2008 through April 26, 2008	417,848	$ 16.38	417,848	$ 25,667,001
April 27, 2008 through May 24, 2008	227,879	$ 14.01	227,879	$ 22,474,053
May 25, 2008 through June 28, 2008	--	--	--	$ 22,474,053
Total	645,727	$ 15.55	645,727	$ 22,474,053

(1) Represents repurchased shares which were retired.

(2) On February 16, 2007, our Board of Directors approved a stock repurchase program, pursuant to which the Company is authorized to purchase up to $100 million of its outstanding common shares. Such repurchases may occur from time to time in the open market, in negotiated transactions, or otherwise. This program has no time limit. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, and other factors. This program was announced in the Company's report on Form 8-K, which was filed on February 21, 2007. The total remaining authorization under the repurchase program was $22,474,053 as of June 28, 2008.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

N/A

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

The Company held its Annual Meeting of Stockholders on May 9, 2008 (the "Annual Meeting") for which proxies were solicited pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended. The following matters were voted on by the Company's stockholders:

Bradley M. Bloom, A. Bruce Cleverly, and Frederick J. Rowan, II were elected as Class II directors to each serve for a three-year term. The following is a schedule of the votes cast:

Nominee	Total votes for	Total votes withheld
Bradley M. Bloom	47,904,019	3,794,422
A. Bruce Cleverly	51,476,776	221,665
Frederick J. Rowan, II	51,357,183	341,258

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

The appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm was ratified.

Total votes for	Total votes against	Total votes abstained
51,609,557	87,565	1,318

ITEM 5. OTHER INFORMATION

N/A

ITEM 6. EXHIBITS

(a) Exhibits:

Exhibit Number	Description of Exhibits
31.1	Rule 13a-15(e)/15d-15(e) and 13a-15(f)/15d-15(f) Certification

31.2	Rule 13a-15(e)/15d-15(e) and 13a-15(f)/15d-15(f) Certification
32	Section 1350 Certification

SIGNATURES

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

CARTER'S, INC.

Date: August 6, 2008	/s/ MICHAEL D. CASEY Michael D. Casey Chief Executive Officer
Date: August 6, 2008	/s/ ANDREW B. NORTH Andrew B. North Interim Chief Financial Officer and Principal Accounting Officer