CARTERS INC
Form 10-Q
October 25, 2018

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 29, 2018 OR

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

Commission file number:
001-31829
CARTER'S, INC.
(Exact name of Registrant as specified in its charter)

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

Phipps Tower
3438 Peachtree Road NE, Suite 1800
Atlanta, Georgia 30326
(Address of principal executive offices, including zip code)
(678) 791-1000
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one)
Large Accelerated Filer (X) Accelerated Filer ( )
Non-Accelerated Filer ( ) (Do not check if a smaller reporting company) Smaller Reporting Company ( )
Emerging Growth Company ( )

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

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

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

Common Stock	Outstanding Shares at October 19, 2018
Common stock, par value $0.01 per share	45,848,908

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PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

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

See accompanying notes to the unaudited condensed consolidated financial statements.

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

NOTE 1 – THE COMPANY

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

NOTE 2 – BASIS OF PRESENTATION

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

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

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

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

Accounting Policies

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

Revenue from Contracts with Customers (ASC No. 606)

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Company uses the five-step model to recognize revenue:

1) Identify the contract with the customer;
2) Identity the performance obligation(s);
3) Determine the transaction price;
4) Allocate the transaction price to each performance obligation if multiple obligations exist; and
5) Recognize the revenue as the performance obligations are satisfied

Performance Obligations

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

When Performance Obligations Are Satisfied

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

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

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

Significant Payment Terms

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

Returns and Refunds

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

Significant Judgments

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

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

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

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

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 - REVENUE RECOGNITION

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

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

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

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

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

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

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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

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

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

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

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

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

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

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

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

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Disaggregation of Revenue

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

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

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

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

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

Accounts Receivable from Customers and Licensees

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

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Contract Assets and Liabilities

The Company's contract assets are not material.

Contract Liabilities

The Company recognizes a contract liability when it has received consideration from the customer and has a future obligation to transfer goods to the customer. Total contract liabilities consisted of the following amounts:

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

*Included with Other current liabilities on the Company's consolidated balance sheet.

Composition of Contract Liabilities

Unredeemed gift cards - the Company is obligated to transfer goods in the future to customers who have purchased gift cards. Periodic changes in the gift card contract liability result from the redemption of gift cards by customers and the recognition of estimated breakage revenue for those gift card balances that are not expected to be redeemed. The majority of our gift cards do not have an expiration date; however, all outstanding gift card balances are classified by the Company as current liabilities since gift cards are redeemable on demand by the valid holder. The majority of the Company's gift cards are redeemed within one year of issuance.

Unredeemed loyalty rewards - points and reward certificates earned by customers under the Company’s loyalty programs represent obligations of the Company to transfer goods to the customer upon redemption. Periodic changes in the loyalty program contract liability result from reward certificate redemptions and expirations. The earning and redemption cycles for our loyalty program are under one year in duration.

NOTE 4 – BUSINESS ACQUISITIONS IN FISCAL 2017

Based on their purchase prices and pre-acquisition operating results and assets, neither of the businesses acquired by the Company in fiscal 2017 met the materiality requirements for preparation and presentation of pro forma financial information, either individually or in the aggregate.

Skip Hop Acquisition

Carter's, Inc.'s wholly-owned subsidiary, The William Carter Company ("TWCC"), acquired 100% of the voting equity interests of Skip Hop Holdings, Inc. and subsidiaries (collectively "Skip Hop") after the close of business on February 22, 2017. The Skip Hop purchase was deemed to be the acquisition of a business under the provisions of ASC No. 805, Business Combinations ("ASC 805"). The Company's consolidated financial statements reflect the consolidation of the financial position, results of operations and cash flows of Skip Hop beginning February 23, 2017.

In the Company's unaudited condensed consolidated balance sheet at July 1, 2017, the preliminary purchase price of approximately $147.3 million, net of $0.8 million cash acquired, was comprised of the following acquired assets and assumed liabilities: $54.2 million of goodwill including an assembled workforce; $92.7 million of intangible assets comprised of a tradename and acquired customer relationships; $54.9 million of tangible assets acquired; and $20.2 million of liabilities in addition to $35.9 million of deferred income tax liabilities.

The measurement period (as defined in ASC 805) for Skip Hop was complete at the end of fiscal 2017 and all measurement period adjustments were reflected in the Company's consolidated balance sheet as of December 30, 2017. As a result of the measurement period adjustments recorded between the acquisition date and the end of fiscal 2017, the net assets acquired consisted of the following: $46.0 million of goodwill including an assembled workforce; $104.1 million of intangible assets comprised of a tradename and acquired customer relationships; $53.9 million of tangible assets acquired; and $20.8 million of liabilities in addition to $36.3 million of deferred income tax liabilities. The adjusted purchase price was approximately $142.5 million, net of $0.8 million of cash acquired.

Acquisition of Mexican Licensee

On August 1, 2017, the Company, through certain of its wholly-owned subsidiaries, acquired the outstanding equity of the Company's licensee in Mexico and a related entity (collectively "Carter's Mexico"). Both entities are incorporated under

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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

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

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE LOSS

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

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

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

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

NOTE 6 – GOODWILL AND INTANGIBLE ASSETS

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

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

Total customer relationships, net

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

		September 30, 2017		
(dollars in thousands)	Weighted-average useful life	Gross amount	Accumulated amortization	Net amount
Carter's goodwill	Indefinite	$ 136,570		$ 136,570
Canada goodwill	Indefinite	42,514		42,514
Skip Hop goodwill	Indefinite	49,190		49,190
Carter's Mexico goodwill	Indefinite	5,919		5,919
Total goodwill		$ 234,193		$ 234,193
Carter's tradename	Indefinite	$ 220,233		$ 220,233
OshKosh tradename	Indefinite	85,500		85,500
Skip Hop tradename	Indefinite	56,800		56,800
Finite-life tradenames	5-20 years	42,040	$ 38,978	3,062
Total tradenames, net		$ 404,573	$ 38,978	$ 365,595
Skip Hop customer relationships, net	15 years	$ 44,800	$ 1,554	$ 43,246
Carter's Mexico customer relationships	10 years	3,376	—	3,376
Total customer relationships, net		$ 48,176	$ 1,554	$ 46,622

Amortization expense for intangible assets subject to amortization was approximately $0.9 million and $0.8 million for the third fiscal quarter ended September 29, 2018 and third fiscal quarter ended September 30, 2017, respectively. For the first three quarters of fiscal 2018 and fiscal 2017, amortization expense was approximately $2.8 million and $1.7 million, respectively.

The estimated amortization expense for the next five fiscal years is as follows:

(dollars in thousands)	Amortization
2019	$ 3,751
2020	$ 3,751
2021	$ 3,751
2022	$ 3,751
2023	$ 3,708

NOTE 7 – COMMON STOCK

Open Market Share Repurchases

The total aggregate remaining capacity under outstanding repurchase authorizations as of September 29, 2018 was approximately $440.1 million, based on settled repurchase transactions. The authorizations have no expiration date.

The Company repurchased and retired shares in open market transactions in the following amounts for the fiscal periods indicated:

	Fiscal quarter ended		Three fiscal quarters ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Number of shares repurchased	543,793	596,178	1,364,420	1,727,587
Aggregate cost of shares repurchased (dollars in thousands)	$56,401	$ 52,742	$145,493	$ 150,974
Average price per share	$103.72	$ 88.47	$106.63	$ 87.39

Future repurchases may occur from time to time in the open market, in privately negotiated transactions, or otherwise. The timing and amount of any repurchases will be determined by the Company's management, based on its evaluation of market conditions, share price, other investment priorities, and other factors.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Dividends

In the third fiscal quarter and three fiscal quarters ended September 29, 2018, the Company declared and paid cash dividends per share of $0.45 and $1.35, respectively. In the third fiscal quarter and three fiscal quarters ended September 30, 2017, the Company declared and paid cash dividends per share of $0.37 and $1.11, respectively. Future declarations of dividends and the establishment of future record and payment dates are at the discretion of the Company's Board of Directors and are based on a number of factors, including the Company's future financial performance and other investment priorities.

Provisions in the indenture governing the senior notes of TWCC and in TWCC's secured revolving credit facility could have the effect of restricting the Company's ability to pay future cash dividends on, or make future repurchases of, its common stock. Provisions related to the indenture governing the senior notes are described in the Company's Annual Report on Form 10-K for the 2017 fiscal year ended December 30, 2017.

NOTE 8 – LONG-TERM DEBT

Long-term debt consisted of the following:

(dollars in thousands)	September 29, 2018	December 30, 2017	September 30, 2017
Senior notes at amounts repayable	$ 400,000	$ 400,000	$ 400,000
Less unamortized issuance-related costs for senior notes	(2,980)	(3,694)	(3,926)
Senior notes, net	397,020	396,306	396,074
Secured revolving credit facility	401,000	221,000	291,000
Total long-term debt, net	$ 798,020	$ 617,306	$ 687,074

Secured Revolving Credit Facility

On September 21, 2018, TWCC and a syndicate of lenders entered into Amendment No. 1 to its fourth amended and restated credit agreement that, among other things, extended the term of the facility from August 25, 2022 to September 21, 2023.

As amended, the secured revolving credit facility provides: (i) a maturity date for the maturity of September 21, 2023 and (ii) an aggregate credit line of $750 million which includes a $650 million U.S. dollar facility and a $100 million multicurrency facility denominated in U.S. dollars, Canadian dollars, Euros, Pounds Sterling, or other currencies agreed to by the applicable lenders. The $650 million U.S. dollar facility is inclusive of a $100 million sub-limit for letters of credit and a swing line sub-limit of $70 million. The $100 million multicurrency facility is inclusive of a $40 million sub-limit for letters of credit and a swing line sub-limit of $15 million.

In addition, the secured revolving credit facility includes additional potential borrowing facilities up to $425 million, which is comprised of a $350 million U.S. dollar revolving credit facility and a $75 million multicurrency revolving credit facility. The U.S. dollar revolving credit facility can also potentially increase to an unlimited borrowing amount so long as the consolidated first lien leverage ratio (as defined in the secured revolving credit facility) does not exceed 2.25:1.00.

Under the secured revolving credit facility, TWCC and its domestic subsidiaries have granted to the collateral agent, for the benefit of the lenders, valid and perfected first priority security interests in substantially all of their present and future assets, excluding certain customary exceptions, and guarantee the obligations of the borrowers. In addition, The Genuine Canadian Corp., as Canadian borrower, and Carter’s Holdings B.V., as Dutch borrower, have each guaranteed the obligations of the other.

As of September 29, 2018, the Company had $401.0 million in outstanding borrowings under its secured revolving credit facility, exclusive of $4.5 million of outstanding letters of credit. As of September 29, 2018, approximately $344.5 million remained available for future borrowing. All outstanding borrowings under the Company's secured revolving credit facility are classified as non-current liabilities on the Company's consolidated balance sheet because of the contractual repayment terms under the credit facility.

As of September 29, 2018, the interest rate applicable to the secured revolving credit facility were 1.375% for LIBOR (London Interbank Offered Rate) rate loans (which may be adjusted based on a leverage-based pricing grid ranging from 1.125% to 1.875%) and 0.375% for base rate loans (which may be adjusted based on a leverage-based pricing grid ranging from 0.125% to 0.875%).

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of September 29, 2018, U.S. dollar borrowings outstanding under the secured revolving credit facility accrued interest at a LIBOR rate plus the applicable base rate, which resulted in a weighted-average borrowing rate of 3.58%. All outstanding Canadian dollar borrowings were repaid during the first quarter of fiscal 2017.

As of September 29, 2018, the Company was in compliance with the financial and other covenants under the secured revolving credit facility.

Senior Notes

As of September 29, 2018, TWCC had outstanding $400 million principal amount of senior notes bearing interest at a fixed rate of 5.25% per annum and maturing on August 15, 2021. The senior notes are unsecured and are fully and unconditionally guaranteed by Carter's, Inc. and certain subsidiaries of TWCC. On the Company's consolidated balance sheet, the senior notes are reported net of certain unamortized issuance-related costs, as shown in the table above.

NOTE 9 – STOCK-BASED COMPENSATION

The Company recorded stock-based compensation expense as follows:

(dollars in thousands)	Fiscal quarter ended		Three fiscal quarters ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Stock options	$1,148	$ 983	$3,604	$ 3,182
Restricted stock:				
Time-based awards	1,881	1,706	5,989	5,668
Performance-based awards	(1,185)	1,116	1,314	3,419
Stock awards	—	—	1,203	1,182
Total	$1,844	$ 3,805	$12,110	$ 13,451

The Company recognizes compensation cost ratably over the applicable performance periods based on the estimated probability of achievement of its performance targets at the end of each period. During the third fiscal quarter of 2018, the achievement of performance target estimates related to certain performance-based grants were revised resulting in a $2.5 million reduction to stock compensation expense.

NOTE 10 – INCOME TAXES

As of September 29, 2018, the Company had gross unrecognized income tax benefits of approximately $15.3 million, of which $12.9 million, if ultimately recognized, may affect the Company's effective income tax rate in the periods settled. The Company has recorded tax positions for which the ultimate deductibility is more likely than not, but for which there is uncertainty about the timing of such deductions.

Included in the reserves for unrecognized tax benefits at September 29, 2018 were approximately $2.0 million of reserves for which the statute of limitations is expected to expire within the next fiscal year. If these tax benefits are ultimately recognized, such recognition, net of federal income taxes, may affect the annual effective income tax rate for fiscal 2018 or fiscal 2019 along with the effective income tax rate in the quarter in which the benefits are recognized.

The Company recognizes interest related to unrecognized tax benefits as a component of interest expense and recognizes penalties related to unrecognized income tax benefits as a component of income tax expense. During the fiscal quarter ended September 29, 2018, interest expense recorded on uncertain tax positions was approximately $0.6 million, while the interest expense recorded for the fiscal quarter ended September 30, 2017 was not material. The Company had approximately $1.9 million, $1.0 million, and $1.1 million of interest accrued on uncertain tax positions as of September 29, 2018, December 30, 2017, and September 30, 2017, respectively.

For the full fiscal year 2018, the Company estimates that its consolidated effective income tax rate will be approximately 22.0%.

U.S. Tax Reform

The provision for income taxes recognized by the Company during the fiscal fourth quarter of 2017 reflected certain provisional estimates for the accounting of the December 22, 2017 enactment of income tax law changes commonly known as the U.S. Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act"). The provisional accounting for the 2017 Tax Act is permitted by SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act, issued in late

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

December 2017. Subsequent adjustments, if any, to the provisional accounting estimates must be reflected in income tax provisions/benefits during one or more periods in fiscal 2018.
During the fourth quarter of fiscal 2017, the Company recorded a provisional tax expense estimate for the one-time transition tax liability for all of its foreign subsidiaries, resulting in an increase in income tax expense of approximately $10.4 million related to foreign earnings. The one-time transition tax is based on the Company's total post-1986 earnings and profits ("E&P") that the Company previously deferred from United States income taxes. During the third quarter of fiscal 2018, the Company completed its calculation of the one-time transition tax for all of its foreign subsidiaries. The adjustments made to this provisional tax expense estimate during the first three quarters of fiscal 2018 were not material. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax, or any additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations. Determining the amount of unrecognized deferred tax liability related to any remaining undistributed foreign earnings not subject to the transition tax and additional outside basis difference in these entities (i.e., basis difference in excess of that subject to the one-time transition tax) is not practicable, but the related cumulative temporary difference as of December 30, 2017 and September 29, 2018 would not result in a material incremental deferred tax liability.

NOTE 11 – FAIR VALUE MEASUREMENTS

The following table summarizes assets and liabilities that are remeasured at fair value each reporting period:

	September 29, 2018			December 30, 2017			September 30, 2017		
(dollars in millions)	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Assets									
Investments[1]	$ 17.6	—	—	$ 16.7	—	—	$ 15.7	—	—
Liabilities									
Foreign exchange forward contracts[2]	—	—	—	—	—	—	—	$ 0.2	—

(1) Included in Other assets on the Company's consolidated balance sheet.
(2) Included in Other current liabilities on the Company's consolidated balance sheet.

Investments

The Company invests in marketable securities, principally equity-based mutual funds, to mitigate the risk associated with the investment return on employee deferrals of compensation. Gains on the investments in marketable securities were $0.7 million and $0.9 million for the third fiscal quarter and the three fiscal quarters ended September 29, 2018, respectively, and were $0.4 million and $1.6 million for the third fiscal quarter and three fiscal quarters ended September 30, 2017, respectively. These amounts are included in Other expense (income), net on the Company's consolidated statement of operations.

Contingent Consideration

The estimated fair value of contingent consideration related to the Skip Hop acquisition was based on a weighted payout probability at the measurement date. Facts and circumstances that occurred subsequent to the acquisition indicated that the contingent earn out arrangement would not be achieved, and therefore approximately $3.6 million was credited to the Company's earnings during the third fiscal quarter ended September 30, 2017.

Borrowings

As of September 29, 2018, the fair value of the Company's $401.0 million in outstanding borrowings under its secured revolving credit facility approximated the carrying value.
The fair value of the Company's senior notes at September 29, 2018 was approximately $406 million. The fair value of these senior notes with a notional value and carrying value (gross of debt cost) of $400 million was estimated using a quoted price as provided in the secondary market, which considers the Company's credit risk and market related conditions, and is therefore within Level 2 of the fair value hierarchy.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 12 – EARNINGS PER SHARE

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

	Fiscal quarter ended		Three fiscal quarters ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Weighted-average number of common and common equivalent shares outstanding:				
Basic number of common shares outstanding	45,990,039	47,303,074	46,399,746	47,829,794
Dilutive effect of equity awards	490,283	541,325	538,422	549,213
Diluted number of common and common equivalent shares outstanding	46,480,322	47,844,399	46,938,168	48,379,007
Basic net income per common share (in thousands, except per share data):				
Net income	$71,770	$ 82,316	$151,506	$ 166,703
Income allocated to participating securities	(540)	(651)	(1,142)	(1,311)
Net income available to common shareholders	$71,230	$ 81,665	$150,364	$ 165,392
Basic net income per common share	$1.55	$ 1.73	$3.24	$ 3.46
Diluted net income per common share (in thousands, except per share data):				
Net income	$71,770	$ 82,316	$151,506	$ 166,703
Income allocated to participating securities	(536)	(645)	(1,134)	(1,301)
Net income available to common shareholders	$71,234	$ 81,671	$150,372	$ 165,402
Diluted net income per common share	$1.53	$ 1.71	$3.20	$ 3.42
Anti-dilutive awards excluded from diluted earnings per share computation	326,129	662,130	266,646	618,826

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 13 – OTHER CURRENT AND LONG-TERM LIABILITIES

Other current liabilities that exceeded five percent of total current liabilities, at the end of any comparable period, were as follows:

(dollars in thousands)	September 29, 2018	December 30, 2017	September 30, 2017
Accrued bonuses and incentive compensation	$ 6,286	$ 27,566	$ 9,328
Income taxes payable	21,124	16,252	28,393
Accrued employee benefits	13,987	21,735	12,503
Accrued and deferred rent	19,137	18,213	18,160

Other long-term liabilities that exceeded five percent of total liabilities, at the end of any comparable period, were as follows:

(dollars in thousands)	September 29, 2018	December 30, 2017	September 30, 2017
Deferred lease incentives	$ 75,331	$ 75,104	$ 76,599

NOTE 14 – COMMITMENTS AND CONTINGENCIES

The Company is subject to various claims and pending or threatened lawsuits in the normal course of business. The Company is not currently a party to any legal proceedings that it believes would have a material adverse impact on its financial position, results of operations, or cash flows.

NOTE 15 – SEGMENT INFORMATION

The table below presents certain information for our reportable segments and unallocated corporate expenses for the periods indicated.

	Fiscal quarter ended				Three fiscal quarters ended			
(dollars in thousands)	September 29, 2018	% of Total Net Sales	September 30, 2017	% of Total Net Sales	September 29, 2018	% of Total Net Sales	September 30, 2017	% of Total Net Sales
Net sales:								
U.S. Retail	$459,101	49.7 %	$ 453,843	47.9 %	$1,244,863	52.4 %	$ 1,209,143	50.9 %
U.S. Wholesale	338,963	36.7 %	369,577	39.0 %	829,272	34.9 %	879,842	37.1 %
International	125,843	13.6 %	124,626	13.1 %	301,755	12.7 %	283,639	12.0 %
Total net sales	$923,907	100.0 %	$ 948,046	100.0 %	$2,375,890	100.0 %	$ 2,372,624	100.0 %
Operating income (loss):		% of Segment Net Sales		% of Segment Net Sales		% of Segment Net Sales		% of Segment Net Sales
U.S. Retail(1)(5)	$47,139	10.3 %	$ 55,519	12.2 %	$122,086	9.8 %	$ 127,441	10.5 %
U.S. Wholesale(2)(5)	67,785	20.0 %	78,572	21.3 %	148,395	17.9 %	184,073	20.9 %
International(5)(6)	12,434	9.9 %	16,726	13.4 %	20,508	6.8 %	28,008	9.9 %
Corporate expenses(3)(4)	(23,801)		(20,369)		(70,152)		(66,307)	
Total operating income	$103,557	11.2 %	$ 130,448	13.8 %	$220,837	9.3 %	$ 273,215	11.5 %

(1) Includes insurance recoveries of approximately $0.4 million associated with storm-related store closures in 2017 for the three fiscal quarters ended September 29, 2018.

(2) Includes approximately $12.8 million of charges related to a customer bankruptcy for the three fiscal quarters ended September 29, 2018.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(4) Includes the following charges:

(dollars in millions)	Fiscal quarter ended September 29, 2018	Fiscal quarter ended September 30, 2017	Three fiscal quarters ended September 29, 2018	Three fiscal quarters ended September 30, 2017
Acquisition contingency fair value adjustment	$ —	$ (3.6)	$ —	$ (3.6)
Direct sourcing initiative	$ —	$ 0.1	$ —	$ 0.3
Acquisition-related costs	$ —	$ 0.8	$ —	$ 3.3

(5) Includes $0.4 million and $0.8 million of certain costs related to inventory acquired from Skip Hop in operating income between U.S. Wholesale, U.S. Retail, and International for the fiscal quarter and three fiscal quarters ended September 30, 2017, respectively.

(6) Fiscal quarter and three fiscal quarters ended September 29, 2018 include approximately $3.5 million in costs associated with changes to the Company's business model in China, which includes inventory and severance charges.

NOTE 16 – PENDING ADOPTION OF RECENT ACCOUNTING PRONOUNCEMENTS

Leases (ASU 2016-02)

In February 2016, the FASB issued new lease accounting guidance in ASU No. 2016-02, Leases-Topic 842, which has been codified in ASC 842, Leases ("ASC 842"). Under this new guidance, lessees will be required to recognize for all leases (with the exception of short-term leases): 1) a lease liability equal to the lessee's obligation to make lease payments arising from a lease, measured on a discounted basis and 2) a right-of-use asset which will represent the lessee's right to use, or control the use of, a specified asset for the lease term. The new standard will be effective for the Company at the beginning of fiscal 2019, including interim periods within the year of adoption. The Company is assessing the implications of applying the practical expedients and accounting policy elections, implementing software to meet the reporting requirements of the new standard, and identifying changes to its business processes and controls to support the adoption of the new standard. The Company believes the adoption will have a material impact on the total assets and total liabilities reported on the Company's consolidated balance sheets, but is not able to quantify the effect on the consolidated balance sheets at this time. However, the Company does not believe adoption of this standard will have a material impact on the Company's consolidated results of operations or cash flows.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02)

In February 2018, the FASB issued ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("ASU 2018-02"). ASU 2018-02 permits a company to reclassify the income tax effects of the U.S. Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") on items within accumulated other comprehensive income or loss ("AOCI-L") to retained earnings. Because most items that are charged to AOCI-L are recorded net of applicable income taxes, the subsequent reclassification of these items from AOCI-L to the statement of operations will be at different income tax rates due to the 2017 Tax Act, thereby leaving a "stranded" tax balance within AOCI-L. ASU 2018-02 will allow a company to transfer these "stranded" amounts from AOCI-L to retained earnings. ASU 2018-02 will be effective for the Company at the beginning of fiscal 2019, with early adoption permitted. The Company has amounts in its AOCI-L for defined benefit retirement plans that were recorded net of applicable income taxes, thus the Company anticipates the transfer of "stranded" tax amounts from its AOCI-L to retained earnings upon the adoption of ASU 2018-02. The effect of the adoption of ASU 2018-02 will not be material to the Company's financial position, and the adoption will have no impact on the Company's results of operations or cash flows.

Credit Losses (ASU 2016-13)

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). This new guidance will change how entities account for credit impairment for trade and other receivables, as well as for certain financial assets and other instruments. ASU 2016-13 will replace the current "incurred loss" model with an "expected loss" model. Under the "incurred loss" model, a loss (or allowance) is recognized only when an event has occurred (such as a payment delinquency) that causes the entity to believe that a loss is probable (i.e., that it has been "incurred"). Under the "expected loss" model, an entity will recognize a loss (or allowance) upon initial recognition of the asset that reflects all future events that will lead to a loss being realized, regardless of whether it is probable that the future event will occur. The "incurred loss" model considers past events and current conditions, while the "expected loss" model includes expectations for the future which have yet to occur. ASU 2016-13 will be effective for the Company at the beginning of fiscal 2020 with early adoption permitted for fiscal 2019, including interim periods therein. The standard will require entities to record a cumulative-effect adjustment to the balance sheet as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating the potential impact that ASU 2016-13 may have on the timing of recognizing future provisions for expected losses on the Company's accounts receivable.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Goodwill Impairment Testing (ASU 2017-04)
In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 will eliminate the requirement to calculate the implied fair value of goodwill (step 2 of the current goodwill impairment test) to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value (i.e., measure the charge based on the current step 1). Any impairment charge will be limited to the amount of goodwill allocated to an affected reporting unit. ASU 2017-04 will not change the current guidance for completing Step 1 of the goodwill impairment test, and an entity will still be able to perform the current optional qualitative goodwill impairment assessment before determining whether to proceed to Step 1. Upon adoption, ASU 2017-04 will be applied prospectively. Adoption for the Company will be effective for annual and interim impairment tests performed beginning in fiscal 2020. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The impact that ASU 2017-04 may have on the Company's financial condition or results of operations will depend on the circumstances of any goodwill impairment event that may occur after adoption.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 17 – GUARANTOR UNAUDITED CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

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

For additional information, refer to the Company's Annual Report on Form 10-K for the 2017 fiscal year ended December 30, 2017.

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

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CARTER’S, INC.
Condensed Consolidating Balance Sheets (unaudited)

As of September 29, 2018
(dollars in thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$—	$70,518	$19,755	$ 33,625	$—	$123,898
Accounts receivable, net	—	235,167	38,986	19,336	—	293,489
Intercompany receivable	—	131,518	123,104	47,869	(302,491)	—
Finished goods inventories	—	385,969	261,141	78,694	(32,819)	692,985
Prepaid expenses and other current assets	—	21,690	23,431	11,879	—	57,000
Total current assets	—	844,862	466,417	191,403	(335,310)	1,167,372
Property, plant, and equipment, net	—	137,709	185,203	37,806	—	360,718
Goodwill	—	136,570	45,368	47,673	—	229,611
Tradenames, net	—	223,117	142,637	—	—	365,754
Customer relationships, net	—	—	42,614	2,911	—	45,525
Other assets	—	25,422	1,690	1,854	—	28,966
Intercompany long-term receivable	—	—	490,514	—	(490,514)	—
Intercompany long-term note receivable	—	100,000	—	—	(100,000)	—
Investment in subsidiaries	811,185	1,117,864	283,169	—	(2,212,218)	—
Total assets	$811,185	$2,585,544	$1,657,612	$ 281,647	$(3,138,042)	$2,197,946
LIABILITIES AND STOCKHOLDERS' EQUITY						
Current liabilities:						
Accounts payable	$—	$121,721	$45,351	$ 18,213	$—	$185,285
Intercompany payables	—	164,290	132,713	5,488	(302,491)	—
Other current liabilities	—	40,703	75,358	16,960	—	133,021
Total current liabilities	—	326,714	253,422	40,661	(302,491)	318,306
Long-term debt	—	798,020	—	—	—	798,020
Deferred income taxes	—	45,480	41,820	588	—	87,888
Intercompany long-term liability	—	490,514	—	—	(490,514)	—
Intercompany long-term note payable	—	—	100,000	—	(100,000)	—
Other long-term liabilities	—	80,812	88,860	12,875	—	182,547
Stockholders' equity	811,185	844,004	1,173,510	227,523	(2,245,037)	811,185
Total liabilities and stockholders' equity	$811,185	$2,585,544	$1,657,612	$ 281,647	$(3,138,042)	$2,197,946

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of December 30, 2017
(dollars in thousands)

	Parent	Subsidiary Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	$ —	$ 129,463	$ 10,030	$ 39,001	$ —	$ 178,494
Accounts receivable, net	—	182,944	40,286	17,331	—	240,561
Intercompany receivable	—	87,702	162,007	58,980	(308,689)	—
Finished goods inventories	—	296,065	206,556	66,569	(20,468)	548,722
Prepaid expenses and other current assets	—	17,012	21,354	14,569	—	52,935
Total current assets	—	713,186	440,233	196,450	(329,157)	1,020,712
Property, plant, and equipment, net	—	147,858	189,511	40,555	—	377,924
Goodwill	—	136,570	45,368	48,486	—	230,424
Tradenames, net	—	223,251	142,300	—	—	365,551
Customer relationships, net	—	—	44,996	3,000	—	47,996