CARTERS INC
Form 424B4
September 24, 2004

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FILED PURSUANT TO RULE 424(b)(4)
REGISTRATION NOS. 333-118630
AND 333-119235

7,554,311 Shares

Common Stock

All of the shares of common stock in the offering are being sold by the selling stockholders identified in this prospectus. Carter's, Inc. will not receive any of the proceeds from the sale of the shares being sold by the selling stockholders.

The common stock is listed on the New York Stock Exchange under the symbol "CRI." The last reported sale price of the common stock on September 23, 2004 was $26.30 per share.

See "Risk Factors" on page 10 to read about factors you should consider before buying shares of the common stock.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Initial price to public	$ 26.20	$ 197,922,948
Underwriting discount	$ 1.20	$ 9,065,173
Proceeds, before expenses, to the selling stockholders	$ 25.00	$ 188,857,775

To the extent that the underwriters sell more than 7,554,311 shares of common stock, the underwriters have the option to purchase up to an additional 1,133,146 shares from the selling stockholders at the initial price to public less the underwriting discount.

Goldman, Sachs & Co.
Banc of America Securities LLC
Credit Suisse First Boston
Morgan Stanley

Prospectus dated September 23, 2004.

PROSPECTUS SUMMARY

This summary highlights the key information contained in this prospectus. Because it is a summary, it does not contain all the information you should consider before investing in our common stock. You should read carefully this entire prospectus. In particular, you should read the section entitled "Risk Factors" and the consolidated financial statements and the notes relating to those statements included elsewhere in this prospectus. The fiscal year of Carter's ends on the Saturday in December or January nearest the last day of December. The terms "baby" and "young children" have specific meanings when used in the children's apparel industry. References to "baby" in this prospectus mean newborns through approximately age one, or up to size 9 months, and references to "young children" in this prospectus mean children from approximately age one to six, or children's clothing size 12 months to size 7. References to share and market share in this prospectus mean market share expressed as a percentage of total retail revenues of a market unless otherwise indicated.

Our Business

We are the largest branded marketer of apparel for babies and young children in the United States with a 6.7% market share of the growing $18.4 billion market in 2003, up substantially from our market share of 4.8% in 2002. Over our 139 years of operation, *Carter's* has become one of the most highly recognized and most trusted brand names in the children's apparel industry. We focus on providing high-quality, essential products at prices that deliver an attractive value to consumers. We believe the value proposition of our products appeals to a broad range of consumers, and our multi-channel sales strategy allows us to reach consumers where they shop. We sell our products under the *Carter's* and *Carter's Classics* brands in our wholesale channel, which includes approximately 300 department store, national chain, and specialty store accounts. Additionally, we currently operate 174 Carter's retail stores located primarily in premier outlet centers throughout the United States. We also sell our products in the mass channel under the *Tykes* brand in over 1,200 Target stores and under our *Child of Mine* brand in over 3,000 Wal-Mart stores nationwide. For the fiscal year ended January 3, 2004, our wholesale channel represented 51% of our total net sales, our retail stores represented 37% of our total net sales, and our mass channel represented 12% of our total net sales.

Since 1992, when the current management team joined Carter's, we have increased net sales from $227 million to $704 million in fiscal 2003. Over the past five years, we have increased net sales at a compound annual growth rate of 11.8%, and we have increased operating income from $27.4 million in fiscal 1998 to $74.6 million in fiscal 2003, yielding a compound annual growth rate of 22.2%. During this five-year period, our pre-tax results were decreased in 1999 by closure costs of $7.1 million, in 2001 by acquisition-related charges of $11.3 million, debt extinguishment charges of $12.5 million, and closure costs of $4.0 million, and in 2003 by debt extinguishment charges of $9.5 million, a management fee termination charge of $2.6 million, and closure costs of $1.0 million.

We market essential, high-volume core apparel products for babies and young children, including bodysuits, pajamas, blanket sleepers, gowns, bibs, towels, washcloths, and receiving blankets. Our top ten baby and sleepwear core products accounted for more than 80% of our baby and sleepwear net sales in fiscal 2003. We believe these core products are consumer staples and are insulated from changes in fashion trends. Whether they are shopping for their own children or purchasing gifts, consumers provide consistent demand for our products as they start wardrobes for the approximately four million babies born each year and replace clothing their children outgrow. In fiscal 2003, we sold over 148 million units of Carter's products to our wholesale and mass channel customers and through our retail stores, an increase of approximately 42% from fiscal 2002.

We are the largest brand of apparel for babies and young children in the department store, national chain, outlet, specialty store, and off-price sales channels with 9.3% of the market in 2003, up from 7.3% in 2002. Our aggregate market shares in 2003 in these channels were approximately 25% for apparel and related products for newborns, also known as layette, and 27% for sleepwear for babies and young children. These market shares represent greater than four and three times, respectively, the market shares of the next largest brand in each category. In these channels, our share of the playclothes market for babies and young children grew from 4.8% in 2002 to 7.1% in 2003.

Our top wholesale customers are leading retailers in the United States, including Kohl's, Babies "R" Us, JCPenney, Sears, May Company, and Federated. In the fourth quarter of fiscal 2000, we began selling our products in the mass channel by launching the *Tykes* brand in all Target stores nationwide. In June of 2003, we began shipping products under our *Child of Mine* brand. Our *Child of Mine* products are now being sold in substantially all Wal-Mart stores nationwide. In addition, we currently extend the reach of the *Carter's*, *Carter's Classics*, *Tykes,* and *Child of Mine* brands in our channels through licensing arrangements with 14 marketers of related baby and young children's products. Collectively, our licensees generated $142.4 million of branded wholesale and mass channel sales in fiscal 2003, resulting in $11.0 million of royalty income to us. See "Business Products and Markets Licensed Products" for a listing of our licensees.

Our Competitive Strengths

We attribute our market leadership, significant opportunities for continued growth, and increased profitability to the following competitive strengths:

Superior Brand Power. Over the past 139 years of providing quality baby and young children's apparel, we have successfully established *Carter's* as a high-quality, trusted, and leading brand among consumers. Ninety-five percent of mothers and grandmothers surveyed knew the *Carter's* name, and over 85% had purchased *Carter's* products. We believe consumers have a strong, emotional connection to the *Carter's* brand, and this consumer trust provides us with substantial brand equity.

Essential, High-Volume Core Product Strategy. We develop and market essential, high-volume apparel products that consumers purchase frequently. The majority of our core styles continue from year to year with variations only to color, fabric, or artistic applications. In the past five years, we have expanded our design team in order to improve our artistic capabilities. Over 95% of baby sales to our wholesale and mass channel customers in fiscal 2003 were of products that we regularly replenish to these customers. This regular replenishment increases our productivity and creates a more stable and predictable revenue base.

Multiple Sales Channels with Broad Consumer Reach. Our multi-channel sales strategy allows us to reach consumers with varying demographic and socio-economic characteristics. In addition to our established wholesale strengths and retail store presence, we sell our products to mass channel stores under the *Tykes* brand in all Target stores and under our *Child of Mine* brand in substantially all Wal-Mart stores nationwide. We believe this new channel allows us to extend our reach to a new group of consumers.

Operational Expertise. We believe that our skill at servicing our customers and our own retail stores with on-time deliveries of high-quality products, our ability to monitor and analyze their inventory levels based on weekly sales data, and our ability to replenish their inventory on a timely basis, have been key drivers in building our market share in the wholesale, retail, and mass channels.

Global Sourcing Network. Over the past five years, we have successfully developed a global sourcing network for our products in over 15 countries with approximately 100 vendors. This global sourcing initiative has enabled us to both improve product quality and reduce product costs. This has allowed us to continue to improve the value proposition of our products for our consumers and establish significant capacity for growth.

Strong Management Team With a Proven Track Record. We have a strong and experienced management team, with our five senior executives averaging more than 20 years of experience in the textile and apparel industries. Since joining Carter's in 1992, our management team has been responsible for increasing net sales at a compound annual growth rate of approximately 11%. In recent years, we have expanded the management team to provide additional expertise in the mass and retail channels, global sourcing, supply-chain logistics, and merchandising. Prior to this offering, our five senior executives benefically own 10.1% of the equity of our company. After this offering, our five senior executives will continue to beneficially own approximately 9.0% of the equity of our company or 8.9% if the underwriters choose to exercise in full their option to purchase additional shares.

Our Growth Strategy

We intend to continue to increase sales and profitability by strengthening our position as the leading apparel brand in the $18.4 billion United States apparel market for babies and young children and growing our market share. Our strategy includes:

Core Product Focus. We intend to expand our strong market shares by continuing to drive core product growth through fabric improvements, new artistic applications, new packaging and presentation strategies, and increased leverage of our brand. In addition, we will continue to provide our major customers with display units that present our core products more visibly on their retail floors. We will also continue to drive market share gains through emphasis on competitive pricing for all core products and clear communication of value and product benefits to consumers.

Leverage Carter's Brands in the Large, Fragmented Playclothes Market. We have a significant opportunity to expand our brands' market share in the highly fragmented, $13 billion playclothes market for babies and young children. In 2003, this market was more than five times the size of the markets for layette and sleepwear combined. We intend to continue to increase sales of our core playclothes products such as t-shirts, leggings, shorts, casual pants, jumpsuits, rompers, and creepers by offering quality products at attractive prices and leveraging our strengths with our existing customers and consumer base. In the most recent four fiscal quarters, our wholesale playclothes revenue increased over 18% as compared to the previous four fiscal quarters.

Expand Presence in Mass Channel. Thirty-one percent of sales in the $18.4 billion United States apparel market for babies and young children is generated through mass channel stores nationwide. Over the past three years, we have built a strong presence in the mass channel with the launch of *Tykes* in fiscal 2000 at Target and *Child of Mine* at Wal-Mart in fiscal 2003. During this period, consolidated revenue grew, resulting in higher gross profit overall but lower gross profit as a percentage of net sales as wholesale and mass channel revenues generally yield lower margins than similar products sold through our retail channel. In 2003, Wal-Mart and Target together represented 76% of mass channel sales of apparel products for babies and young children in the United States. We believe we have a significant opportunity to grow our brands in the mass channel over the next several years. We have recently announced our intent to replace the *Tykes* brand name in Target stores with our *Just One Year* brand beginning in December 2004.

Extend Reach and Increase Productivity of Retail Stores. We intend to continue to increase the percentage of core products in our retail stores, creating an easier shopping environment with improved product adjacencies, and implementing simple, more effective promotions and clearer in-store communications. We believe these initiatives will increase store productivity. We intend to add eight to ten retail stores per year. In fiscal 2003, all of our retail stores that had been open for more than twelve months were profitable. Generally, new stores are profitable within the first year of operation and produce a payback of initial investment within one year after opening.

Continue Expansion of Global Sourcing. We define full-package global sourcing as the purchase of complete, ready-for-sale products from vendors located primarily in the Far East. Full-package global sourcing now accounts for approximately 90% of our total product mix and enhances our speed to market. We believe cost reduction and margin improvement are possible as we further expand and leverage our global sourcing.

Optimize Supply Chain. We have significant opportunities to continue to improve our supply chain. We are committed to further shortening product lead times and creating a more effective distribution model through a variety of operational and sourcing initiatives. In addition, our core product focus allows us to continue to reduce product complexity. We expect these initiatives will enable us to improve demand forecasting, lower distribution costs, and increase inventory turns.

General

We are incorporated in the State of Delaware. We reincorporated in Delaware on September 30, 2003, and changed our name to Carter's, Inc. Prior to the reincorporation, we were named Carter Holdings, Inc., and we were a Massachusetts corporation. Our principal executive offices are located at The Proscenium, 1170 Peachtree Street NE, Suite 900, Atlanta, Georgia 30309. Our telephone number is (404) 745-2700. Our website address is www.carters.com. Information contained on our website or that can be accessed through our website is not incorporated by reference in this prospectus. You should not consider information contained in or accessible through our website to be part of this prospectus.

In August 2001, Berkshire Fund V, Limited Partnership, Berkshire Fund V Coinvestment Fund, Limited Partnership, and Berkshire Investors LLC, each of which is an investment fund affiliated with Berkshire Partners LLC, purchased control of our Company from Investcorp S.A., which had been our controlling stockholder since acquiring us in 1996. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Overview." Our management team has remained in place since 1992 and has provided continuity to our business through both of these acquisitions. Berkshire Partners is a Boston-based private investment firm that invests in businesses in a wide variety of industries that offer strong growth prospects and are supported by high-quality management teams.

Risk Factors

We face risks operating our business that you should consider before investing in our Company. For a discussion of the significant risks associated with operating our business or with investing in our common stock, you should read the section entitled "Risk Factors" beginning on page 10 of this prospectus.

This Offering

Common stock offered by the selling stockholders	7,554,311 shares
Common stock outstanding after this offering	28,274,332 shares
Use of proceeds	We will not receive any proceeds from the sale of shares by the selling stockholders other than the exercise price of shares being sold that are currently subject to options.
NYSE symbol	"CRI"
Risk factors	See **"Risk Factors"** beginning on page 10 of this prospectus for a discussion of the significant risks associated with operating our business or with investing in our common stock.

The number of shares of our common stock to be outstanding after this offering include 28,088,112 shares actually outstanding as of August 27, 2004 and 186,220 shares of our common stock to be issued upon exercise of options in connection with the closing of this offering with a weighted average exercise price of $3.24 per share.

The number of shares of our common stock outstanding on August 27, 2004 excludes 4,241,444 shares of common stock reserved for issuance under our 2003 Equity Incentive Plan, under which options to purchase 4,069,881 shares of common stock were outstanding as of that date.

In addition, the underwriters have a 30-day option to purchase up to 1,133,146 additional shares from the selling stockholders. Some of the disclosure in this prospectus would be different if the underwriters exercise this option. Unless we tell you otherwise, the information in this prospectus assumes that the underwriters will not exercise this option.

Summary Historical Consolidated Financial Data

The summary historical consolidated financial data for the period from December 31, 2000 through August 14, 2001, as of the end of and for the period from August 15, 2001 through December 29, 2001, and as of the end of and for each of the fiscal years 2002 and 2003 were derived from our audited consolidated financial statements and, other than the consolidated financial data as of December 29, 2001, are included elsewhere in this prospectus. The summary historical consolidated financial data for each of the six-month periods ended July 5, 2003 and July 3, 2004 and as of July 3, 2004 were derived from our unaudited condensed consolidated financial statements included elsewhere in this prospectus. The summary historical consolidated financial data as of July 5, 2003 was derived from our unaudited condensed consolidated financial statements.

As a result of adjustments made in connection with our acquisition by investment funds affiliated with Berkshire Partners LLC, and associated investors in August 2001, which we refer to as the "Acquisition," the results of operations for the period from August 15, 2001 through December 29, 2001, fiscal years 2002 and 2003, the six-month periods ended July 5, 2003 and July 3, 2004 (the "Successor" periods) are not comparable to periods prior to the Acquisition (the "Predecessor" periods). This data is qualified in its entirety by the more detailed information appearing in our consolidated historical financial statements and related notes, our "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other financial information included elsewhere in this prospectus.

(dollars in thousands, except for share data)

	Predecessor(a)(b)	Successor(c)				
	Period from December 31, 2000 through August 14, 2001	Period from August 15, 2001 through December 29, 2001	Fiscal Years		Six-month periods ended	
			2002	2003	July 5, 2003	July 3, 2004
Wholesale sales	$ 144,779	$ 118,116	$ 301,993	$ 356,888	$ 162,232	$ 164,088
Retail sales	127,088	108,091	253,751	263,206	113,521	119,235
Mass channel sales	10,860	9,573	23,803	83,732	30,248	55,704
Total net sales	282,727	235,780	579,547	703,826	306,001	339,027
Cost of goods sold	182,863	149,352	352,151	448,540	195,542	213,166
Gross profit	99,864	86,428	227,396	255,286	110,459	125,861
Selling, general, and administrative expenses	88,895	57,987	174,110	188,028	86,764	95,394
Acquisition-related charges(d)	11,289					
Write-down of long-lived assets(e)	3,156		150			
Closure costs(f)	1,116	(268)		1,041		540
Deferred charge write-off(g)			923			
Management fee termination(h)				2,602		
Royalty income	(4,993)	(2,624)	(8,352)	(11,025)	(4,457)	(5,668)
Operating income	401	31,333	60,565	74,640	28,152	35,595
Interest income	(73)	(207)	(347)	(387)	(226)	(235)
Loss on extinguishment of debt(i)	12,525			9,455		
Interest expense	11,803	11,307	28,648	26,646	13,747	9,223
(Loss) income before income taxes	(23,854)	20,233	32,264	38,926	14,631	26,607
(Benefit from) provision for income taxes	(6,857)	7,395	13,011	15,648	5,633	10,377
Net (loss) income	$ (16,997)	$ 12,838	$ 19,253	$ 23,278	$ 8,998	$ 16,230
PER COMMON SHARE DATA(j):						
Basic net (loss) income	$ (0.44)	$ 0.57	$ 0.86	$ 0.99	$ 0.40	$ 0.58
Diluted net (loss) income	$ (0.44)	$ 0.56	$ 0.82	$ 0.92	$ 0.38	$ 0.54
Dividends				$ 1.10		
Basic weighted average shares	38,752,744	22,332,136	22,453,088	23,611,372	22,550,452	27,993,791
Diluted weighted average shares	38,752,744	23,086,845	23,544,900	25,187,492	23,974,808	29,875,271
BALANCE SHEET DATA (end of period):						
Working capital(k)		$ 111,148	$ 131,085	$ 150,632	$ 142,942	$ 163,499
Total assets		604,162	643,349	646,102	643,118	667,830
Total debt, including current maturities		298,742	297,622	212,713	291,943	204,929
Stockholders' equity		158,338	179,359	272,536	188,457	289,935
OTHER DATA:						
EBITDA(l)	$ 121	$ 38,251	$ 79,258	$ 87,401	$ 38,143	$ 46,542
Capital expenditures	9,480	9,556	18,009	17,347	6,810	10,711

(a)

On a pro forma basis, assuming Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") was in effect for all periods presented, pro forma loss before income taxes would have been $(21.8) million and pro forma net loss would have been $(15.5) million for the Predecessor period from December 31, 2000 through August 14, 2001.

(b) In the first quarter of fiscal 2003, we adopted the provisions of SFAS No. 145, "Rescission of FASB statements No. 4, 44, and 64, Amendment of FASB statement No. 13, and Technical Corrections" ("SFAS 145"). SFAS 145 rescinds Financial Accounting Standards Board ("FASB") Statement No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result, the criteria in Accounting Principles Board Opinion 30 will now be used to classify those gains and losses. Accordingly, charges related to the extinguishment of debt during the Predecessor period from December 31, 2000 through August 14, 2001, as more fully described in note (i) below, have been reclassified to conform with the provisions of SFAS 145.

(c)
As a result of the Acquisition, we adjusted our assets and liabilities to their estimated fair values as of August 15, 2001. In addition, we entered into new financing arrangements and changed our capital structure in connection with the Acquisition. At the time of the Acquisition, we adopted the provisions of SFAS No. 141, "Business Combinations" ("SFAS 141") and SFAS 142, "Goodwill and Other Intangible Assets," which affect the amortization of goodwill and other intangibles. Accordingly, the results as of the end of and for the Successor period from August 15, 2001 through December 29, 2001, the Successor fiscal years 2002 and 2003 and the Successor six-month periods ended July 5, 2003 and July 3, 2004 are not comparable to periods prior to the Acquisition.

(d)
The Acquisition-related charges for the Predecessor period from December 31, 2000 through August 14, 2001 include $4.5 million in management bonuses and $6.8 million in other seller expenses.

(e)
The $3.2 million write-down of long-lived assets for the Predecessor period from December 31, 2000 through August 14, 2001 relates to the closure of two domestic manufacturing facilities in that period. The $150,000 write-down in the Successor fiscal year 2002 relates to a reduction in the carrying value of land and a building held for sale located in Barnesville, Georgia that were sold in the Successor fiscal year 2003.

(f)
The $1.1 million in closure costs for the Predecessor period from December 31, 2000 through August 14, 2001 relate to closure costs associated with two domestic manufacturing facilities. The $1.0 million in closure costs for the Successor 2003 fiscal year relates to the closure of our two sewing facilities located in Costa Rica and includes $0.2 million of asset impairment charges, $0.5 million of severance, and $0.3 million of other closure costs. The $0.5 million in closure costs recorded during the first half of fiscal 2004 relates to $74,000 of additional severance and $371,000 of other exit costs in Costa Rica and $95,000 of severance related to the closure of our distribution facility in Leola, Pennsylvania.

(g)
The deferred charge write-off in Successor fiscal 2002 reflects the write-off of $923,000 of previously deferred costs associated with the filing of a registration statement on Form S-1 in August 2002, to register the initial public offering of our common stock.

(h)
Reflects the payment of $2.6 million to terminate the Berkshire Partners LLC management agreement upon completion of our initial public offering of our common stock on October 29, 2003.

(i)
Debt extinguishment charges for the Predecessor period December 31, 2000 through August 14, 2001 reflect the write-off of debt issuance costs of approximately $4.7 million and a debt redemption premium of approximately $7.8 million. Debt extinguishment charges for the Successor fiscal year 2003 reflect the write-off of $2.4 million of debt issuance costs resulting from the redemption of $61.3 million of our operating subsidiary's 10.875% senior subordinated notes and the prepayment of $11.3 million in term loan indebtedness, a debt redemption premium of approximately $6.7 million, and a $0.4 million write-off of the related note discount.

(j)
As a result of the Acquisition, our capital structure and the number of outstanding shares were changed. Accordingly, earnings per share in Predecessor periods are not comparable to earnings per share in Successor periods.

(k)
Represents total current assets less total current liabilities.

(l)
EBITDA represents earnings before interest, income tax expense, depreciation, and amortization. EBITDA is presented because it is one measurement used by management in assessing financial performance, and we believe it is helpful to investors, securities analysts, and other interested parties, in evaluating performance of companies in our industry. EBITDA also closely tracks, after specified adjustments, the defined terms "Consolidated Adjusted EBITDA" and "Consolidated Cash Flow" that are the bases for calculating our financial debt covenants and restrictions under the senior credit facility and our senior subordinated notes. EBITDA is not a measurement of financial performance under generally accepted accounting principles in the United States of America. It should not be considered as an alternative to cash flow from operating activities, as a measure of liquidity, or an alternative to net income indicating our operating performance or any other measures of performance derived in accordance with generally accepted accounting principles in the United States of America. Our definition and calculation of EBITDA may not be comparable to similarly titled measures used by other companies.

A reconciliation of EBITDA to net (loss) income is presented below ($000):

	Predecessor(a)(b)	Successor(c)				
	Period from December 31, 2000 through August 14, 2001	Period from August 15, 2001 through December 29, 2001	Fiscal Years		Six-month periods ended	
			2002	2003	July 5, 2003	July 3, 2004
OTHER DATA:						
EBITDA(l)	$ 121	$ 38,251	$ 79,258	$ 87,401	$ 38,143	$ 46,542
Depreciation and amortization expense	(12,245)	(6,918)	(18,693)	(22,216)	(9,991)	(10,947)
Interest income	73	207	347	387	226	235
Interest expense	(11,803)	(11,307)	(28,648)	(26,646)	(13,747)	(9,223)
Benefit from (provision for) income taxes	6,857	(7,395)	(13,011)	(15,648)	(5,633)	(10,377)
Net (loss) income	$ (16,997)	$ 12,838	$ 19,253	$ 23,278	$ 8,998	$ 16,230

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risk factors set forth below and all other information contained in this prospectus before making an investment decision regarding our common stock. The risks described below are the significant risk factors, currently known and unique to us, that make an investment in our common stock speculative or risky. You could lose part or all of your investment.

Risks Relating to Our Business

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

In fiscal 2003, we derived approximately 45.7% of our total net sales from our top eight customers, including mass channel customers. We expect that these customers will continue to represent a significant portion of our sales in the future. However, we do not enter into long-term sales contracts with our key 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 key customers may significantly decrease its or their business with us or terminate its or their relationships with us. Any such decrease or termination or a decrease in our key customers' business could result in a material decrease in our revenue.

Retail trends could result in increased downward pressure on our prices.

With the growing trend toward retail trade consolidation, we increasingly depend upon a reduced number of key retailers whose bargaining strength is growing. Changes in the policies of our retail trade customers, such as inventory de-stocking, limitations on access to shelf space, and other conditions could result in lower net sales. Further consolidations in the retail industry could result in price and other competition that could damage our business.

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

While 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 or independent manufacturers or licensees or their labor practices. A violation of our vendor policies, labor laws, or other laws by these vendors or independent manufacturers could interrupt or otherwise disrupt our sourcing 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.

We currently source substantially all of our sewing, embroidery, and cutting, and a substantial portion of our fabric production through our offshore facilities and other offshore production arrangements. Our dependence on foreign supply sources could result in disruptions to our operations in the event of political instability, international events, or new foreign regulations and such disruptions may increase our cost of goods sold and decrease gross profit.

We source a substantial portion of our offshore production through a network of various vendors in the Far East, coordinated by our Far East agents. We expect to source more of our production offshore over time. The following could disrupt our foreign supply chain, increase our cost of goods sold, decrease gross profit, or impact our ability to get products to our customers:

- political instability or other international events resulting in the disruption of trade from foreign countries in which our manufacturing facilities are located;

- the imposition of new regulations relating to imports, duties, taxes, and other charges on imports; or

- the occurrence of an epidemic, the spread of which may impact our ability to obtain products on a timely basis.

These and other events beyond our control could interrupt production in offshore facilities or delay receipt of our products in the United States.

The loss of one or more of our major domestic suppliers for raw materials may interrupt our supplies.

Of the fabrics we source in the United States, we purchase a majority from a few vendors. The loss of one or more of these vendors could interrupt our supply chain and impact our ability to deliver products to our customers.

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 business include Oshkosh B'Gosh, Disney, and private label product offerings. Our primary competitors in the mass channel include Gerber, Disney, and private label product offerings. Our primary competitors in the retail store channel include The Gap, Oshkosh B'Gosh, Gymboree, and The Children's Place. 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; and
- devote greater resources to the marketing and sale of their products and adopt more aggressive pricing policies than we can.

Our substantial leverage could adversely affect our financial condition.

On July 3, 2004, we had total debt of approximately $204.9 million outstanding (consisting of $113.1 million of our senior subordinated notes and $91.8 million of secured borrowings under our senior credit facility). In addition, we and our subsidiaries are permitted to incur substantial additional indebtedness in the future.

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

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

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

Governmental regulations and environmental risks applicable to our business may require us to take actions that would limit our business and increase our costs.

Our business is subject to federal, state, provincial, local, and foreign laws and regulations, including regulations with respect to air emissions, wastewater discharges, and the generation, handling, storage, transportation, treatment, and disposal of waste materials. Although we believe we are in substantial compliance with all applicable laws and regulations, legal requirements are frequently changed and subject to interpretation, and we are unable to predict the ultimate cost of compliance with these requirements or their effect on our operations. We may be required to make significant expenditures to comply with governmental laws and regulations. Complying with existing or future laws or regulations may materially limit our business and increase our costs.

Risks Relating to Investment in Our Common Stock

Shares eligible for future sale may cause the market price of our common stock to drop significantly, even if our business is doing well.

The potential for sales of substantial amounts of our common stock in the public market after this offering may adversely affect the market price of our common stock. After this offering is concluded, there will be 28,274,332 shares of our common stock outstanding assuming no exercise of options other than those being exercised by selling stockholders in connection with this offering. The 7,187,500 shares of our common stock that we and our stockholders sold in our initial public offering on October 29, 2003 are, and the 7,554,311 shares of our common stock that the selling stockholders intend to sell in this offering will be, freely tradable without restriction or further registration under the federal securities laws, unless purchased by our "affiliates" as that term is defined in Rule 144 under the Securities Act of 1933. Upon completion of this offering, 12,657,396 shares of our common stock, including the shares owned by investment funds affiliated with Berkshire Partners LLC, will be "restricted securities" within the meaning of Rule 144 under the Securities Act and will be eligible for resale subject to the volume, manner of sale, holding period, and other limitations of Rule 144. We have granted investment funds affiliated with Berkshire Partners LLC the right to require us to register additional shares of our common stock. These shares, and the shares held by our directors and executive officers and the selling stockholders, are subject to lock-up agreements and may not be sold to the public during the 90-day period following the date of this prospectus without the consent of the underwriters.

In addition to outstanding shares eligible for sale, 4,069,881 shares of our common stock were issuable as of August 27, 2004 under outstanding stock options granted to several executive officers, directors, employees, and consultants under our 2003 Equity Incentive Plan.

Investment funds affiliated with Berkshire Partners LLC have significant influence over us and their interests may differ from your interests as a stockholder.

Investment funds affiliated with Berkshire Partners LLC will own 40.2% of our outstanding common stock after this offering, and 36.3% if the underwriters exercise in full their option to purchase additional shares. As a result, they will have significant influence over our business, policies, affairs, and the outcome of any corporate transaction or other matter submitted to our stockholders for approval, including the election of our board of directors, mergers, consolidations,

and sales of substantially all of our assets. We cannot assure you that the interests of Berkshire Partners, or the investment funds affiliated with Berkshire Partners, will be consistent with your interests as a stockholder.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made forward-looking statements in this prospectus. These forward-looking statements are subject to risks and uncertainties and include statements regarding our financial position, business strategy, and other plans and objectives for future operations and any other statements, which are not historical facts. Although we believe that these statements are based on reasonable assumptions, they are subject to numerous factors, risks, and uncertainties that could cause actual outcomes and results to be materially different from those projected. These factors, risks, and uncertainties include, among other things:

- the loss of one or more of our wholesale and mass channel customers;
- changes in retail trends and consumer preferences;
- our dependence on foreign supply sources;
- our ability to maintain our reputation;
- our dependence on our major vendors of raw materials;
- our ability to compete;
- our substantial leverage;
- governmental and environmental regulations; and
- our ability to grow and improve operating efficiencies.

These factors expressly qualify all subsequent oral and written forward-looking statements attributable to us or persons acting on our behalf. Except for any ongoing obligations to disclose material information as required by the federal securities laws, we do not have any intention or obligation to update forward-looking statements after we distribute this prospectus.

Actual results may differ materially from those suggested by the forward-looking statements for various reasons, including those discussed under "Risk Factors" in this prospectus.

INDUSTRY AND OTHER DATA

All references to demographic data in this prospectus are based upon industry publications, census information, and our data. In this prospectus, we rely on and refer to information regarding the baby and young children's apparel market from the 2003 NPD Group, Inc. purchase data released February 5, 2004. NPD is a nationally recognized marketing research firm that specializes in apparel research. Information regarding brand recognition and market perception is taken from *Carter's Infant and Children's Wear Brand: Awareness & Attitudes,* a study by Fitzgerald & Co. that we commissioned, dated April 2001. Fitzgerald & Co. is a brand marketing firm located in Atlanta, Georgia. Although we believe this information is reliable, we have not independently verified and cannot guarantee the accuracy or

completeness of the information. All references in this prospectus to the numbers of stores and accounts and licensees are as of July 3, 2004, unless we otherwise indicate.

USE OF PROCEEDS

We will not receive any proceeds from the sale of shares by the selling stockholders other than the exercise price of shares being sold that are currently subject to options.

PRICE RANGE OF COMMON STOCK

Since October 24, 2003, our common stock has traded on the New York Stock Exchange under the symbol "CRI." Prior to October 24, 2003, our common stock was not publicly traded. The last reported sale price per share of our common stock on September 23, 2004 was $26.30. As of August 27, 2004 there were 2,767 holders of record of our common stock.

The following table sets forth for the period indicated the high and low sales prices per share of common stock as reported by the New York Stock Exchange:

2003	**High**	**Low**
Fourth quarter (commencing October 24, 2003)	$ 29.90	$ 23.40
2004	**High**	**Low**
First quarter	$ 31.35	$ 24.90
Second quarter	$ 31.72	$ 27.75

DIVIDEND POLICY

On July 31, 2003, prior to the initial public offering, we paid a cash dividend of approximately $24.9 million on the outstanding shares of our common stock to the stockholders of record as of July 30, 2003. At the same time, we paid a special bonus of approximately $2.5 million to our vested option holders. We have not paid any dividends since July 31, 2003.

We do not anticipate paying additional cash dividends on our common stock in the foreseeable future and intend to retain future earnings, if any, for reinvestment in the future operation and expansion of our business and related development activities. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, terms of financing arrangements, capital requirements, and such other factors as our board of directors deems relevant. Provisions in the indenture governing our subsidiary's senior subordinated notes restrict our operating subsidiary's ability to pay us dividends except to the extent that our operating subsidiary has cumulative net income, in which case it may use 50% of that amount to pay dividends or make other restricted payments. Provisions in our senior credit facility prevent us and our operating subsidiary from paying future dividends and making other distributions and transfers.

CAPITALIZATION

The following table presents our consolidated capitalization as of July 3, 2004. This table should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and notes thereto included elsewhere in this prospectus.

	As of July 3, 2004(1)	
	(dollars in thousands, except for share data)	
Debt:		
Senior credit facility:		
Revolving loan facility	$	
Term loan(2)		91,790
Senior subordinated notes		113,139
Total debt		204,929
Stockholders' equity:		
Preferred stock, $0.01 par value; 100,000 shares authorized; none issued or outstanding		
Common stock, voting; $0.01 par value; 40,000,000 shares authorized; 28,073,103 shares issued and outstanding(3)		281
Additional paid-in capital		242,948
Retained earnings		46,706
Total stockholders' equity		289,935
Total capitalization	$	494,864

(1) Our capitalization as of July 3, 2004 does not give effect to estimated expenses of $586,247 payable by us in connection with this offering.

(2) As of July 3, 2004, we had outstanding letters of credit of $16.6 million. The weighted average interest rate on outstanding borrowings under the credit facility was 3.46% as of July 3, 2004.

(3) Does not include 4,241,444 shares of our common stock reserved for issuance under our 2003 Equity Incentive Plan, under which options to purchase 4,069,881 shares of our common stock were outstanding as of August 27, 2004. We will issue 186,220 shares of common stock upon exercise of options in connection with the closing of this offering.

SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

The selected historical consolidated financial data as of the end of and for each of the 1999 and 2000 fiscal years, for the period from December 31, 2000 through August 14, 2001, as of the end of and for the period from August 15, 2001 through December 29, 2001, and as of the end of and for the 2002 and 2003 fiscal years were derived from our audited consolidated financial statements. The audited consolidated financial statements for the period from December 31, 2000 through August 14, 2001, for the period from August 15, 2001 through December 29, 2001, and as of the end of and for the 2002 and 2003 fiscal years are included elsewhere in this prospectus. The selected historical consolidated financial data for each of the six-month periods ended July 5, 2003 and July 3, 2004 and as of July 3, 2004 were derived from our unaudited condensed consolidated financial statements included elsewhere in this prospectus. The selected historical consolidated financial data as of July 5, 2003 was derived from our unaudited condensed consolidated financial statements.

As a result of adjustments made in connection with the Acquisition, the results of operations for the Successor periods from August 15, 2001 through December 29, 2001, the 2002 and 2003 fiscal years and the six-month periods ended July 5, 2003 and July 3, 2004 are not comparable to prior periods. This data is qualified in its entirety by the more detailed information appearing in our consolidated historical financial statements and related notes, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other financial information included elsewhere in this prospectus.

(dollars in thousands, except for share data)

	Predecessor(a)			Successor(b)				
	Fiscal Years		Period from December 31, 2000 through August 14, 2001(c)	Period from August 15, 2001 through December 29, 2001	Fiscal Years		Six-month periods ended	
	1999	2000			2002	2003	July 5, 2003	July 3, 2004
OPERATING DATA:								
Wholesale sales	$ 223,612	$ 244,136	$ 144,779	$ 118,116	$ 301,993	$ 356,888	$ 162,232	$ 164,088
Retail sales	183,312	215,280	127,088	108,091	253,751	263,206	113,521	119,235
Mass channel sales		3,959	10,860	9,573	23,803	83,732	30,248	55,704
Total net sales	406,924	463,375	282,727	235,780	579,547	703,826	306,001	339,027
Cost of goods sold	271,844	293,340	182,863	149,352	352,151	448,540	195,542	213,166
Gross profit	135,080	170,035	99,864	86,428	227,396	255,286	110,459	125,861
Selling, general, and administrative expenses	117,334	135,322	88,895	57,987	174,110	188,028	86,764	95,394
Acquisition-related charges(d)			11,289					
Write-down of long-lived assets(e)	7,124		3,156		150			
Closure costs(f)			1,116	(268)		1,041		540
Deferred charge write-off(g)					923			
Management fee termination(h)						2,602		
Royalty income	(4,233)	(5,808)	(4,993)	(2,624)	(8,352)	(11,025)	(4,457)	(5,668)
Operating income	14,855	40,521	401	31,333	60,565	74,640	28,152	35,595
Interest income		(303)	(73)	(207)	(347)	(387)	(226)	(235)
Loss on extinguishment of debt(i)			12,525			9,455		
Interest expense	20,437	18,982	11,803	11,307	28,648	26,646	13,747	9,223
(Loss) income before income taxes and cumulative effect of change in accounting principle	(5,582)	21,842	(23,854)	20,233	32,264	38,926	14,631	26,607
(Benefit from) provision for income taxes	(1,782)	8,835	(6,857)	7,395	13,011	15,648	5,633	10,377
(Loss) income before cumulative effect of change in accounting principle	(3,800)	13,007	(16,997)	12,838	19,253	23,278	8,998	16,230
Cumulative effect of change in accounting principle for revenue recognition, net of tax benefit of		354						

(dollars in thousands, except for share data)

$217(j)

Net (loss) income	$ (3,800)	$ 12,653	$ (16,997)	$ 12,838	$ 19,253	$ 23,278	$ 8,998	$ 16,230
PER COMMON SHARE DATA(k):								
Basic net (loss) income	$ (0.10)	$ 0.33	$ (0.44)	$ 0.57	$ 0.86	$ 0.99	$ 0.40	$ 0.58
Diluted net (loss) income	$ (0.10)	$ 0.33	$ (0.44)	$ 0.56	$ 0.82	$ 0.92	$ 0.38	$ 0.54
Dividends						$ 1.10		
Basic weighted average shares	38,926,812	38,759,508	38,752,744	22,332,136	22,453,088	23,611,372	22,550,452	27,993,791
Diluted weighted average shares	38,926,812	38,759,508	38,752,744	23,086,845	23,544,900	25,187,492	23,974,808	29,875,271
OTHER DATA:								
Depreciation and amortization	$ 16,855	$ 17,520	$ 12,245	$ 6,918	$ 18,693	$ 22,216	$ 9,991	$ 10,947
Capital expenditures	12,726	17,179	9,480	9,556	18,009	17,347	6,810	10,711
BALANCE SHEET DATA (end of period):								
Working capital(l)	$ 83,471	$ 87,862		$ 111,148	$ 131,085	$ 150,632	$ 142,942	$ 163,499
Property, plant, and equipment, net	51,776	54,441		46,503	50,476	50,502	49,952	52,627
Total assets	314,944	327,545		604,162	643,349	646,102	643,118	667,830
Total debt, including current maturities	162,300	161,400		298,742	297,622	212,713	291,943	204,929
Stockholders' equity	56,953	69,596		158,338	179,359	272,536	188,457	289,935
CASH FLOW DATA:								
Net cash provided by (used in) operating activities	$ 36,458	$ 24,197	$ 168	$ 31,113	$ 27,304	$ 40,506	$ (21,938)	$ (5,363)
Net cash used in investing activities	(12,362)	(19,217)	(9,266)	(247,459)	(15,554)	(16,472)	(5,935)	(9,760)
Net cash (used in) provided by financing activities	(24,667)	(4,698)	5,925	240,514	(880)	(23,535)	(2,730)	(7,762)

(a)
On a pro forma basis, assuming SFAS 142 was in effect for all periods presented, pro forma (loss) income before income taxes and cumulative effect of change in accounting principle for revenue recognition would have been $(21.8) million for the Predecessor period from December 31, 2000 through August 14, 2001, $25.1 million for the Predecessor fiscal year 2000, and $(2.3) million for the Predecessor fiscal year 1999. Pro forma net (loss) income would have been $(15.5) million for the Predecessor period from December 31, 2000 through August 14, 2001, $14.9 million for the Predecessor fiscal year 2000, and $(1.5) million for the Predecessor fiscal year 1999.

(b)
As a result of the Acquisition, we adjusted our assets and liabilities to their estimated fair values as of August 15, 2001. In addition, we entered into new financing arrangements and changed our capital structure in connection with the Acquisition. At the time of the Acquisition, we adopted the provisions of SFAS 141 and SFAS 142, which affect the amortization of goodwill and other intangibles. Accordingly, the results as of the end of and for the Successor period from August 15, 2001 through December 29, 2001, for the Successor fiscal years 2002 and 2003 and the Successor six-month periods ended July 5, 2003 and July 3, 2004 are not comparable to prior periods.

(c)
In the first quarter of fiscal 2003, we adopted the provisions of SFAS 145 which rescinds FASB Statement No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result, the criteria in Accounting Principles Board Opinion 30 will now be used to classify those gains and losses. Accordingly, charges related to the extinguishment of debt during the Predecessor period from December 31, 2000 through August 14, 2001, as more fully described in note (i) below, have been reclassified to conform with the provisions of SFAS 145.

(d)
The Acquisition-related charges for the Predecessor period from December 31, 2000 through August 14, 2001 include $4.5 million in management bonuses and $6.8 million in other seller expenses.

(e)
The write-down of long-lived assets for the Predecessor fiscal year 1999 represents the $6.9 million write-down in the carrying value of our textile facility assets, for which the operations were closed in December 1999, and a loss of approximately $200,000 on property, plant, and equipment related to the closures of three domestic sewing facilities. The $3.2 million write-down of long-lived assets for the Predecessor period from December 31, 2000 through August 14, 2001 relates to the closure of two domestic manufacturing facilities in that period. The $150,000 write-down in the Successor fiscal year 2002 relates to a reduction in the carrying value of land and a building held for sale located in Barnesville, Georgia that were sold in the Successor fiscal year 2003.

(f)
The $1.1 million in closure costs for the Predecessor period from December 31, 2000 through August 14, 2001 relate to closure costs associated with the two domestic manufacturing facilities. The $1.0 million in closure costs for the Successor 2003 fiscal year relates to the closure of our two sewing facilities located in Costa Rica and includes $0.2 million of asset impairment charges, $0.5 million of severance, and $0.3 million of other closure costs. The $0.5 million in closure costs recorded during the first half of fiscal 2004 relates to $74,000 of additional severance and $371,000 of other exit costs in Costa Rica and $95,000 relates to the closure of our distribution facility in Leola, Pennsylvania.

(g)
The deferred charge write-off in the Successor fiscal year 2002 reflects the write-off of $923,000 of previously deferred costs associated with the filing of a registration statement on Form S-1 in August 2002, to register the initial public offering of our common stock.

(h)
Reflects the payment of $2.6 million to terminate the Berkshire Partners LLC management agreement upon completion of our initial public offering of our common stock on October 29, 2003.

(i)
Debt extinguishment charges for the Predecessor period December 31, 2000 through August 14, 2001 reflect the write-off of debt issuance costs of approximately $4.7 million and a debt redemption premium of approximately $7.8 million. Debt extinguishment charges for the Successor 2003 fiscal year reflect the write-off of $2.4 million of debt issuance costs resulting from the redemption of $61.3 million of our operating subsidiary's 10.875% senior subordinated notes and the prepayment of $11.3 million in term loan indebtedness, a debt redemption premium of approximately $6.7 million, and a $0.4 million write-off of the related note discount.

(j)
In fiscal 2000, we recorded the cumulative effect of a change in accounting principle in order to comply with guidance provided by the Securities and Exchange Commission's Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements." On a pro forma basis, assuming this accounting change for revenue recognition is applied retroactively, net income (loss) would have been $13.0 million in fiscal 2000 and $(3.4) million in fiscal 1999.

(k)
As a result of the Acquisition, our capital structure and the number of outstanding shares were changed. Accordingly, earnings per share in Predecessor periods are not comparable to earnings per share in Successor periods.

(l)
Represents total current assets less total current liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our results of operations and current financial condition. You should read this discussion in conjunction with our consolidated historical financial statements and notes included elsewhere in this prospectus. Our discussion of our results of operations and financial condition includes various forward-looking statements about our markets, the demand for our products, and our future results. We based these statements on assumptions that we consider reasonable. Actual results may differ materially from those suggested by our forward-looking statements for various reasons including those discussed in the "Risk Factors" beginning on page 10 of this prospectus. Those risk factors expressly qualify all subsequent oral and written forward-looking statements attributable to us or persons acting on our behalf. Except for any ongoing obligations to disclose material information as required by the federal securities laws, we do not have any intention or obligation to update forward-looking statements included in this prospectus after we file this prospectus.

Overview

We are the largest branded marketer of apparel for babies and young children in the United States with a 2003 market share of 6.7%, up from 4.8% in 2002. We sell our products to approximately 300 department store, national chain, and specialty accounts, which together accounted for 51% of our net sales during fiscal 2003. Additionally, we currently operate 174 Carter's retail stores, which accounted for 37% of our net sales during fiscal 2003. We also sell our products in the mass channel under the *Tykes* brand in over 1,200 Target stores and under our *Child of Mine* brand in over 3,000 Wal-Mart stores nationwide. Sales from the mass channel accounted for 12% of our net sales during fiscal 2003.

Consolidated net sales have increased from $406.9 million in fiscal 1999 to $703.8 million in fiscal 2003. This represents a compound annual growth rate of 14.7%. During this period, wholesale net sales have increased at a compound annual growth rate of 12.4%, from $223.6 million to $356.9 million; net sales at our Carter's retail stores increased at a compound annual growth rate of 9.5% from $183.3 million to $263.2 million; and sales in the mass channel (which began during the fourth quarter of fiscal 2000) increased from $4.0 million to $83.7 million. We believe the increase in wholesale net sales resulted primarily from the strength of the *Carter's* brand in the market place relative to our branded and private label competitors. The increase in our retail stores' net sales resulted primarily from new store openings and same store sales increases. We believe the mass channel represents a significant growth opportunity for us. In fiscal 2003, Target and Wal-Mart together represented 23% of all sales of apparel products for babies and young children in the United States.

Growth in recent years has been driven by the strong performance of our core products made possible through our global sourcing strategy. We have hired people with experience in sourcing products from third-party manufacturers throughout the world, primarily from the Far East. Since launching our global sourcing initiative, we have experienced significant improvement in product quality, lower product costs, and improvement in product margins. Our global sourcing network has also enabled us to more competitively price our products, increase our market share, and enter the mass channel. In December 2000, we successfully launched the *Tykes* brand at all Target stores; and in June 2003, we began shipping products under our *Child of Mine* brand to substantially all Wal-Mart stores nationwide.

On October 29, 2003, we completed an initial public offering of our common stock including the sale of 5,390,625 shares by us and 1,796,875 shares by the selling stockholders, primarily Berkshire Partners LLC and its affiliates. Our proceeds from the offering totaled $93.9 million. On

November 28, 2003, we used approximately $68.7 million of the proceeds to redeem approximately $61.3 million in outstanding senior subordinated notes and pay a redemption premium of approximately $6.7 million and related accrued interest charges of $0.7 million. We used approximately $2.6 million of the net proceeds to terminate the Berkshire Partners LLC management agreement and used approximately $11.3 million to prepay amounts outstanding under the term loan as required by the senior credit facility. We used the remaining proceeds for working capital and other general corporate purposes.

On August 15, 2001, investment funds affiliated with Berkshire Partners LLC purchased control of us from Investcorp S.A., which had been our controlling stockholder since acquiring us in fiscal 1996. Financing for the Acquisition and related transactions totaled $468.2 million and was provided by: $24.0 million in new revolving loan facility borrowings; $125.0 million in new term loan borrowings; $173.7 million from the sale by our operating subsidiary of senior subordinated notes; and $145.5 million of capital invested by investment funds affiliated with Berkshire Partners LLC and other investors, including rollover equity by our management of $18.3 million.

The proceeds of the Acquisition and financing were used to purchase our existing equity ($252.5 million), pay for selling stockholders' transaction expenses ($19.1 million), pay for buyers' transaction expenses ($4.0 million), pay debt issuance costs ($13.4 million), and retire all outstanding balances on previously outstanding long term debt, including accrued interest thereon ($174.8 million). In addition, $4.4 million of proceeds were held as cash for temporary working capital purposes.

As a result of the Acquisition, our assets and liabilities were adjusted to their estimated fair values as of August 15, 2001. The seven and one-half month period prior to the Acquisition includes Acquisition-related charges, principally sellers' expenses, such as management bonuses and professional fees, debt extinguishment charges for debt redemption premiums, and the write-off of deferred debt issuance costs on debt retired as a result of the Acquisition and refinancing. The Predecessor periods include amortization expense on our tradename and goodwill. The Successor periods reflect increased interest expense, the amortization of licensing agreements and cessation of amortization on our tradename and goodwill due to the adoption of SFAS 141 and SFAS 142. Accordingly, the results of operations for the Predecessor and Successor periods are not comparable.

For discussion purposes only, our fiscal 2001 results discussed below represent the mathematical addition of the historical results for the Predecessor period from December 31, 2000 through August 14, 2001 and the Successor period from August 15, 2001 through December 29, 2001. This approach is not consistent with generally accepted accounting principles and yields results that are not comparable on a period-to-period basis, due to the new basis of accounting established at the Acquisition date. However, management believes it is the most meaningful way to comment on the results of operations.

Our fiscal year ends on the Saturday in December or January nearest to the last day of December. Consistent with this policy, fiscal 2004 will end on January 1, 2005 and fiscal 2003 ended on January 3, 2004. As a result, fiscal 2004 will contain 52 weeks of financial results and fiscal 2003 contained 53 weeks of financial results. The additional week in fiscal 2003 was included in the first quarter of fiscal 2003. Therefore, our results for the first half of fiscal 2004 reflect our financial position as of July 3, 2004 and for the 26-week period then ended. The first half of fiscal 2003 ended on July 5, 2003 and included 27 weeks of financial results. Fiscal 2002 ended on December 28, 2002 and contained 52 weeks of financial results. Fiscal 2001 ended on December 29, 2001 and contained 52 weeks of financial results.

Results of Operations

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

	Fiscal Years			Six-month periods ended	
	2001	2002	2003	July 5, 2003	July 3, 2004
Statements of Operations:					
Wholesale sales	50.7%	52.1%	50.7%	53.0%	48.4%
Retail sales	45.4	43.8	37.4	37.1	35.2
Mass channel sales	3.9	4.1	11.9	9.9	16.4
Net sales	100.0	100.0	100.0	100.0	100.0
Cost of goods sold	64.1	60.8	63.7	63.9	62.9
Gross profit	35.9	39.2	36.3	36.1	37.1
Selling, general, and administrative expenses	28.3	30.0	26.7	28.4	28.1
Other charges	3.0	0.1	0.5		0.2
Royalty income	(1.5)	(1.4)	(1.6)	(1.5)	(1.7)
Operating income	6.1	10.5	10.6	9.2	10.5
Loss on extinguishment of debt	2.4		1.4		
Interest expense, net	4.4	4.9	3.7	4.4	2.7
(Loss) income before income taxes	(0.7)	5.6	5.5	4.8	7.8
Provision for income taxes	0.1	2.3	2.2	1.9	3.0
Net (loss) income	(0.8)%	3.3%	3.3%	2.9%	4.8%
Number of retail stores at end of period	151	156	169	159	174

Six-month period ended July 3, 2004 compared to six-month period ended July 5, 2003

Net Sales. In the first half of fiscal 2004, consolidated net sales were $339.0 million, an increase of $33.0 million, or 10.8%, as compared with $306.0 million for the first half of fiscal 2003. The increase in the first half of fiscal 2004 over the prior year primarily reflects growth in sales to the mass channel, including sales of our *Child of Mine* brand to Wal-Mart, which launched in June of 2003, and growth in sales in our retail channel.

In the first half of fiscal 2004, wholesale sales increased $1.9 million, or 1.1%, to $164.1 million from $162.2 million in the first half of fiscal 2003. Wholesale sales, excluding off-price sales in the first half of fiscal 2004, increased $3.4 million, or 2.2%, to $155.3 million from $151.9 million in the first half of fiscal 2003. The increase in wholesale sales for the first half of fiscal 2004 was driven primarily by strong sleepwear sales.

Mass channel sales in the first half of fiscal 2004 increased $25.5 million, or 84.2%, to $55.7 million from $30.2 million in the first half of fiscal 2003. This revenue growth for the first half of fiscal 2004 primarily reflects sales of our *Child of Mine* brand that began selling to Wal-Mart in the latter part of the second quarter of fiscal 2003. Also contributing to this growth were increased sales of the *Tykes* brand sold to Target.

In the first half of fiscal 2004, retail store sales increased $5.7 million, or 5.0%, to $119.2 million from $113.5 million in the first half of fiscal 2003. Such revenue growth was driven by incremental

sales of $7.4 million generated from new stores opened subsequent to July 5, 2003 and a comparable store sales increase of $1.9 million, or 1.8%, based on 158 locations. Such increases were partially offset by the impact of store closures of $0.5 million and an additional week of selling in the first half of fiscal 2003 of $3.1 million. There were a total of 174 stores as of July 3, 2004. We plan to open five stores and close four stores during the balance of fiscal 2004. We do not expect to incur any significant costs as a result of these store closures.

Gross Profit. Gross profit increased $15.4 million, or 13.9%, to $125.9 million in the first half of fiscal 2004 compared to $110.5 million in the first half of fiscal 2003. As a percentage of net sales, gross profit in the first half of fiscal 2004 increased to 37.1% from 36.1% in the first half of fiscal 2003. This increase in gross profit, relative to sales, for the first half of fiscal 2004 resulted primarily from favorable product costs, lower levels of inventory provisions, due to our focus on core products, and the inventory adjustment, noted below offset by a higher mix of mass channel revenues that generally yield lower margins than our wholesale and retail channels. As described in Note 4 to the accompanying unaudited condensed consolidated financial statements, we recorded a favorable adjustment of $1.5 million to correct adjustments to cost of sales and inventory made during fiscal 2003 and the first quarter of fiscal 2004.

Selling, General, and Administrative Expenses. In the first half of fiscal 2004, selling, general, and administrative expenses increased $8.6 million, or 9.9%, to $95.4 million from $86.8 million in the first half of fiscal 2003. As a percentage of net sales, these expenses decreased to 28.1% in the first half of fiscal 2004 from 28.4% in the first half of fiscal 2003. Such improvements reflect the benefit of operating leverage.

Closure Costs. In June of 2004, we decided to exit our distribution facility in Leola, Pennsylvania in order to consolidate our distribution operations and reduce costs. We recorded approximately $95,000 of severance costs during the first half of fiscal 2004. In July of 2003, we decided to exit our Costa Rican sewing facilities, given our ability to obtain lower costs from third-party suppliers. In the first half of fiscal 2004, we recorded approximately $74,000 of severance costs and $371,000 of other closure costs.

Royalty Income. We license the use of our *Carter's, Carter's Classics,* and *Child of Mine* names and sublicense the *Tykes* name to certain licensees. During the first half of fiscal 2004, royalty income was approximately $5.7 million, an increase of $1.2 million, or 27.2%, over the first half of fiscal 2003. The increase in the first half of fiscal 2004 resulted primarily from royalties earned on licensed sales of our *Child of Mine* brand by our licensee partners who began shipping their products during the third quarter of fiscal 2003.

Operating Income. Operating income for the first half of fiscal 2004 increased $7.4 million to $35.6 million from $28.2 million in the first half of fiscal 2003. Operating income, as a percentage of net sales, increased to 10.5% in the first half of fiscal 2004 compared to 9.2% in the first half of fiscal 2003. The increase in operating income for the first half of fiscal 2004 reflects the benefit from revenue growth, increases in gross profit, and leveraging of operating expenses, described above.

Interest Expense, Net. In the first half of fiscal 2004, interest expense decreased $4.5 million to $9.0 million from $13.5 million in the first half of fiscal 2003. This decrease is attributable to the redemption of approximately $61.3 million of our 10.875% senior subordinated notes in the fourth quarter of fiscal 2003, lower variable interest rates on reduced levels of term loan indebtedness, and the additional week of interest in the first half of fiscal 2003.

Income Taxes. In the first half of fiscal 2004, we recorded a provision for income taxes of $10.4 million compared to $5.6 million in the first half of fiscal 2003. Our effective tax rate was approximately 39.0% during the first half of fiscal 2004 and 38.5% during the first half of fiscal 2003.

Net Income. As a result of the factors noted above, net income for the first half of fiscal 2004 was $16.2 million compared to $9.0 million in the first half of fiscal 2003.

Fiscal year ended January 3, 2004 compared to fiscal year ended December 28, 2002

Net Sales. Consolidated net sales for fiscal 2003 were $703.8 million, an increase of $124.3 million, or 21.4%, compared to $579.5 million in fiscal 2002. This revenue growth has been driven by strong product performance resulting from our focus on improving the value of our core products through the expansion of our global sourcing network, effective merchandising strategies, and revenue from our new *Child of Mine* brand launched in June 2003, which is now being sold in substantially all Wal-Mart stores nationwide.

Total wholesale sales increased $54.9 million, or 18.2%, to $356.9 million in fiscal 2003 from $302.0 million in fiscal 2002. In fiscal 2003, wholesale sales, excluding off-price sales, increased $49.6 million, or 17.4%, to $335.2 million from $285.5 million in fiscal 2002. The increase in wholesale sales during fiscal 2003 reflects the growth of our baby and playclothes product lines offset by lower sleepwear revenue. This performance was driven by our focus on improving the value of our high-volume, core products and focus on improving customer service levels.

Retail store sales increased $9.5 million, or 3.7%, to $263.2 million in fiscal 2003 from $253.8 million in fiscal 2002. The driver of the revenue increase in fiscal 2003 was incremental revenue of $20.6 million generated from new store openings offset by the impact of store closures of $6.8 million and a comparable store sales decline of $4.3 million, or 1.8%, based on 148 locations. During fiscal 2003, we opened 15 stores and closed two stores. There were a total of 169 stores as of January 3, 2004 compared to 156 stores at December 28, 2002.

Mass channel sales increased $59.9 million to $83.7 million in fiscal 2003 compared to $23.8 million in fiscal 2002. This revenue growth reflects sales of our new *Child of Mine* brand. Also contributing to this growth were increased sales of the *Tykes* brand to Target. This growth resulted from additional floor space and productivity gained in existing stores and the opening of new Target stores.

Gross Profit. In fiscal 2003, gross profit increased $27.9 million, or 12.3%, to $255.3 million compared to $227.4 million in fiscal 2002. Gross profit as a percentage of net sales in fiscal 2003 decreased to 36.3% compared to 39.2% in fiscal 2002. The decrease in gross profit, relative to sales, reflects a higher mix of wholesale and mass channel sales, which yield lower margins than similar products sold through our retail channel. Retail sales were 37% of consolidated net sales in 2003 as compared to 44% in fiscal 2002. Also contributing to the decline in gross profit, as a percentage of sales, was the impact of accelerated depreciation charges of approximately $1.3 million, recorded in the third and fourth quarters of fiscal 2003 relating to the closure of our Costa Rican sewing facilities.

Selling, General, and Administrative Expenses. In fiscal 2003, selling, general, and administrative expenses increased $13.9 million, or 8.0%, to $188.0 million from $174.1 million in fiscal 2002. As a percentage of net sales, these expenses decreased to 26.7% in fiscal 2003 from 30.0% in fiscal 2002. The decrease, relative to sales, was due primarily to our ability to grow revenue at a faster rate than our selling, general, and administrative expenses and a special executive bonus of $5.0 million paid in fiscal 2002 that did not recur in fiscal 2003, partially offset by higher distribution costs driven by unit volume growth and a $2.5 million payment to vested option holders of our common stock in July 2003.

Closure Costs. In July of 2003, we decided to exit our Costa Rican sewing facilities given our ability to obtain lower costs from third-party suppliers. In addition to the accelerated depreciation charges, described above, we recorded approximately $0.2 million of asset impairment charges,

$0.5 million of severance, and $0.3 million of other closure costs during the third and fourth quarters of fiscal 2003. Approximately $0.9 million of additional closure costs will be recorded during the first quarter of fiscal 2004.

Management Fee Termination. In the fourth quarter of fiscal 2003, upon completion of our initial public offering on October 29, 2003, we paid $2.6 million to terminate the Berkshire Partners LLC management agreement. Under the agreement, which was scheduled to expire in 2005, we paid an annual fee of $1.65 million.

Royalty Income. We license the use of the *Carter's*, *Carter's Classics*, and *Child of Mine* names and sublicense the *Tykes* name to certain licensees. In fiscal 2003, royalty income increased 32.0% to $11.0 million compared to $8.4 million in fiscal 2002. This increase reflects continued expansion of our licensed product placement with our key wholesale customers and licensed sales of our new *Child of Mine* brand by our licensee partners who began shipping their products during the third quarter of fiscal 2003.

Operating Income. Operating income for fiscal 2003 increased $14.1 million to $74.6 million compared to $60.6 million in fiscal 2002. Operating income, as a percentage of net sales, was 10.6% in fiscal 2003 as compared to 10.5% in fiscal 2002. The increase in operating income reflects the benefit from revenue growth, increased gross profit, and leveraging of operating expenses. Fiscal 2003 results included $1.0 million in closure costs, $1.3 million in accelerated depreciation, $2.6 million to terminate the Berkshire Partners LLC management agreement, and a $2.5 million special bonus paid to vested option holders in July 2003. Fiscal 2002 results included a $5.0 million special executive bonus, which did not recur in 2003.

Interest Expense, Net. Interest expense in fiscal 2003 decreased $2.0 million, or 7.2%, to $26.3 million from $28.3 million in fiscal 2002. This decrease is attributable to lower variable interest rates on reduced levels of term loan indebtedness and the redemption of approximately $61.3 million of our 10.875% senior subordinated notes on November 28, 2003, partially offset by an additional week of interest expense.

Loss on Extinguishment of Debt. On November 28, 2003, we used the proceeds of the initial public offering to redeem $61.3 million of our 10.875% senior subordinated notes. In connection with this redemption, we incurred redemption premiums of approximately $6.7 million, wrote-off $2.2 million of deferred debt issuance costs, and expensed $0.4 million related to the note discount. We also prepaid $11.3 million in term loan indebtedness and subsequently wrote-off $0.2 million of deferred debt issuance costs.

Income Taxes. Our effective tax rate was 40.2% for fiscal 2003 and 40.3% for fiscal 2002. Our effective tax rates in fiscal 2003 and 2002 were higher than the statutory rate due to the impact of certain non-deductible costs. See Note 8 to the accompanying consolidated financial statements for the reconciliation of the federal statutory tax rate to our effective tax rate.

Net Income. Our fiscal 2003 net income increased 20.9% to $23.3 million as compared to $19.3 million in fiscal 2002 as a result of the factors described above.

Fiscal year ended December 28, 2002 compared to fiscal year ended December 29, 2001

Net Sales. Consolidated net sales for fiscal 2002 were $579.5 million, an increase of $61.0 million, or 11.8%, compared to $518.5 million in fiscal 2001. This continued revenue growth and strong product performance was driven by our focus on core products, expansion of our global sourcing network, effective merchandising strategies, investments in display units, and the strength of our *Carter's* brand.

Wholesale sales increased $39.1 million, or 14.9%, to $302.0 million in fiscal 2002 from $262.9 million in fiscal 2001. In fiscal 2002, wholesale net sales, excluding off-price sales, increased $35.1 million, or 14.0%, to $285.5 million from $250.5 million in fiscal 2001. The increase in wholesale sales during fiscal 2002 reflects the growth of our baby and playclothes product lines due to our focus on improving the value of our core products. This increase was offset by lower demand for our sleepwear product line.

Retail store sales increased $18.6 million, or 7.9%, in fiscal 2002 to $253.8 million from $235.2 million in fiscal 2001. The increase in sales for the year resulted primarily from increased growth in all of our major product markets. Comparable store sales in our retail channel increased 4.4% in fiscal 2002, based on 142 locations, and increased 6.5% in fiscal 2001, based on 138 locations. In addition, sales increased due to incremental revenues generated from ten new stores added during fiscal 2002. Five stores were closed during fiscal 2002, and during fiscal 2001 we opened nine stores and closed five stores.

Mass channel sales increased $3.4 million, or 16.5%, to $23.8 million in fiscal 2002 compared to $20.4 million in fiscal 2001. This revenue growth came primarily from our sleepwear product line, and was due, in part, to strong product performance and increased sales from additional floor space gained in existing stores and through the opening of new Target stores.

Gross Profit. In fiscal 2002, gross profit increased $41.1 million, or 22.1%, to $227.4 million compared to $186.3 million in fiscal 2001 due to the increased sales and improved gross margin compared to fiscal 2001. Gross profit as a percentage of net sales in fiscal 2002 increased to 39.2% compared to 35.9% in fiscal 2001. This increase in gross margin reflects the continued expansion of our global sourcing strategy, which has enabled us to source better quality products with improved fabric and garment construction at lower costs. These improvements in gross margin also include the impact of a $4.5 million charge recorded in fiscal 2001 related to the amortization of the step-up in the inventory valuation at Acquisition. Excluding this Acquisition adjustment, gross profit, as a percentage of net sales, would have been 36.8% in fiscal 2001. Gross margin in fiscal 2001 also included closure costs and lower margins on excess inventory dispositions.

Selling, General, and Administrative Expenses. In fiscal 2002, selling, general, and administrative expenses increased $27.2 million, or 18.5%, to $174.1 million from $146.9 million in fiscal 2001. As a percentage of net sales, these expenses increased to 30.0% in fiscal 2002 from 28.3% in fiscal 2001. The increase relative to sales was due primarily to a special executive bonus of $5.0 million, increased distribution costs, and fees related to a strategic consulting arrangement. These increases were partially offset by the benefit from our ability to grow our revenue at a faster rate than our selling, general, and administrative expenses and $1.3 million in costs incurred in connection with activities leading up to the Acquisition in fiscal 2001.

Acquisition-related charges/Write-down of Long-Lived Assets/Deferred Charge Write-Off. In the fourth quarter of fiscal 2002, we recorded a charge of approximately $150,000 related to a reduction in the carrying value of the land and building held for sale located in Barnesville, Georgia. We also expensed approximately $923,000 of previously deferred costs related to the preparation and filing of a registration statement on Form S-1 in August 2002, to register the initial public offering of our common stock.

As described in Note 1 to the accompanying consolidated financial statements for the fiscal year ended December 29, 2001, we incurred Predecessor Acquisition-related charges in connection with the sale of our company including $4.5 million in management bonuses and $6.8 million in seller expenses.

As described in Note 15 to the accompanying consolidated financial statements, we closed two of our manufacturing facilities during the Predecessor period of fiscal 2001. In the first quarter of

fiscal 2001, we closed our Harlingen, Texas sewing facility and recognized a charge