CARTER WILLIAM CO /GA/
Form 10-K405
March 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

/X/ ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 29, 2001

/ / TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

COMMISSION FILE NUMBER:

333-22155

THE WILLIAM CARTER COMPANY

(Exact name of registrant as specified in its charter)

MASSACHUSETTS	04-1156680
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

THE PROSCENIUM
1170 PEACHTREE STREET NE, SUITE 900
ATLANTA, GEORGIA 30309
(Address of principal executive offices, including zip code)

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

Securities registered pursuant to Section 12 (b) of the Act: None

Securities registered pursuant to Section 12 (g) of the Act: None

Indicate by check 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. /X/

Aggregate market value of voting and non-voting common equity held by non-affiliates: None

Documents incorporated by reference: None

PART I

ITEM 1. BUSINESS

GENERAL

The William Carter Company ("Carter's," "we," "our" and "us") is the largest branded marketer of baby apparel and a leading marketer of young children's apparel. Over our 137 years of operation, CARTER'S has become one of the most highly recognized and trusted brand names in the children's apparel industry. We sell our products under the CARTER'S, CARTER'S CLASSICS and TYKES brand names to more than 8,200 department, national chain, specialty and discount stores, representing over 420 accounts, as well as through our 151 retail outlet stores. Our wholesale channel represented 56% of our total sales and our retail outlet channel represented 44% for the fiscal year ended December 29, 2001. In the department, national chain, specialty and outlet store distribution channels, we are the leading provider of layette, baby sleepwear and young children's sleepwear. Our market share in fiscal 2001 in the department, national chain, specialty and outlet store distribution channels was approximately 27% for layette, approximately 45% for baby sleepwear and approximately 34% for young children's sleepwear. Our top wholesale customers include Kohl's, Kids R Us, JCPenny, Sears, Federated, May Company, Mervyn's and Target. Our market share data is based on information provided by the NPD Group, Inc. In the past year, NPD Group, Inc. has improved the way it collects its data, and therefore while our market share data is not directly comparable to market share data we have reported for prior years, it is more representative of consumer behavior. In each of these categories, our market share in these channels was more than five times that of our nearest branded competitor. We focus on marketing high-volume, core products, such as bodysuits, pajamas and blanket sleepers that are insulated from changes in fashion trends and generate consistent demand from season to season.

The William Carter Company is a wholly-owned subsidiary of Carter Holdings, Inc. ("Holdings"). Holdings has no significant assets or investments other than the shares of stock of The William Carter Company.

We are a Massachusetts corporation. Our principal executive office is located at The Proscenium, 1170 Peachtree Street NE, Suite 900, Atlanta, Georgia 30309, and our telephone number is (404) 745-2700.

PRODUCTS AND MARKETS

We design, manufacture, source and market a broad array of baby and young children's apparel. We have three strategic business units focused on baby, sleepwear and playclothes. We are the leader in the baby and sleepwear portions of the market and have a strong presence in the young children's playclothes market. We also license our brand names to other companies to create a complete collection of coordinating products including bedding, strollers, underwear, shoes, room decor, toys and more. Our brand positioning is based on our strategy of creating quality core products that are differentiated through imaginative and creative artistic application.

BABY

We are the leading brand in baby for the following products: layette, baby sleepwear and baby playclothes. In fiscal 2001, we generated $177.7 million in sales of these products. Layette includes a complete range of products primarily made of cotton for newborns, including bodysuits, undershirts, towels, washcloths, receiving blankets, layette gowns, bibs, caps and booties. We are the leading supplier of layette products within the department, specialty, national chain and outlet store distribution channels. We attribute our leading market position to our distinctive print designs, unique embroideries and our reputation for quality. We tier our products through marketing programs targeted toward three consumer groups: gift-givers, experienced mothers and first-time mothers. JUST ONE YEAR, or JOY,

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LIMITED EDITIONS and CARTER'S CLASSICS are complete nursery programs designed for first-time mothers and gift-givers. CARTER'S STARTERS, the core component of our layette business, provides the experienced mother with the essentials in value-focused multi-packs. Our primary competitors in the layette market are private label manufacturers and manufacturers of licensed-character products.

SLEEPWEAR

Sleepwear includes pajamas, cotton long underwear and blanket sleepers in sizes 12 months to 7. In fiscal 2001, we generated $142.5 million in sales of these products. We are the leading supplier of sleepwear products within the department, specialty, national chain and outlet store distribution channels. As in layette, we try to differentiate our sleepwear products from the competition by offering high volume core products with creative artwork in consumer-tested prints and embroideries with an emotional appeal. In addition, we believe our sleepwear product line features more functional, higher quality products than those of our competitors. When we introduced flame-retardant cotton sleepwear in 2000, we strengthened our leading position in the sleepwear industry. Our primary competitors in the sleepwear market are private label manufacturers and licensed character products.

PLAYCLOTHES

Playclothes includes knit and woven cotton apparel for everyday use. In fiscal 2001, we generated $130.9 million in sales of these products. The market for baby and young children's playclothes apparel, sizes 0-7, in fiscal 2001 was almost six times the size of the layette and sleepwear markets combined. We continue to focus on strengthening playclothes products by introducing original print designs and innovative artistic applications in order to increase sales and market share. We believe that this product focus, in addition to our high brand name awareness, strong wholesale customer relationships and expanded global sourcing capabilities, will increase our playclothes sales. The young children's playclothes market is highly fragmented, with no one branded competitor having more than a 4.5% share of the market.

OTHER PRODUCTS

Other products include bedding, outerwear, shoes, socks, diaper bags, gift sets, toys, room decor and hair accessories, including products for which we license the CARTER'S, CARTER'S CLASSICS and TYKES names. In fiscal 2001, we generated $55.5 million in sales of these products through our retail outlet stores.

DISCOUNT STORE PRODUCT LINE

Carter's launched a line for baby and toddler products at Target stores

in the fourth quarter of 2000 representing our initial entry into the discount channel of distribution. This product line includes layette, sleepwear and baby playclothes along with a range of licensed products, including hosiery, bedding, toys and room decor products. We launched the line with a nationwide floor set in December 2000, using the TYKES brand name. We believe that our presence in Target stores, along with our comprehensive in-store signage and fixture program, will firmly establish our products in the discount store market. In fiscal 2001, we generated $25.4 million in baby and toddler apparel sales of the TYKES brand through Target and our retail outlet stores.

LICENSING

We license the CARTER'S, CARTER'S CLASSICS and TYKES names to other companies for use on baby and young children's products including bedding, outerwear, shoes, socks, room decor, toys, stationery, strollers and hair accessories and related products. In fiscal 2001, we earned $7.6 million in royalty income on licensed products. In 1998, we entered into a license agreement for the rights to John

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Lennon's Real Love artwork collection for use on children's apparel, accessories and related products. In 1999, we entered into an artwork agreement with Emu Namae, a Japanese artist, to use his art on children's apparel, accessories and licensed products. These artwork agreements are part of our LIMITED EDITIONS program which utilizes partnerships with outside artists and concepts to further distinguish our brand from our competitors.

PRODUCT DESIGN AND DEVELOPMENT

Our product strategy is built on developing and marketing high-volume core products that are differentiated by creative application. Basic, high-volume core products are designed with simple and cost-effective construction. A high percentage of the products continue from season to season with the same fabric and construction, and are varied only through color and the artistic application of embroideries and prints. We have three strategic business teams focused on baby, sleepwear and playclothes. These business teams are skilled in identifying and developing high-volume, core products. Each team follows a disciplined approach to fabric use, color rationalization and productivity and is supported by a dedicated art department and state-of-the-art design systems. This disciplined approach to product design is meant to reduce risk and large seasonal fluctuations. We have a validation process for testing and introducing products. Artwork, color and product silhouettes are tested with consumer panels, key wholesale accounts and an internal creative steering committee. Additional quantitative measurements include pre-season bookings, weekly over-the-counter selling results and weekly re-order rates on baby products.

DISTRIBUTION AND SALES

We sell our products to wholesale accounts and through our retail outlet stores. In fiscal 2001, sales through the wholesale channel, including discount channel revenues, accounted for 56% of total sales, while the retail outlet channel accounted for 44% of total sales. No one wholesale customer accounts for more than 10% of consolidated net sales.

WHOLESALE OPERATIONS

We sell our products in the United States through a network of approximately 30 sales professionals. Sales professionals work with their respective department or specialty store account to establish annual plans for "basics"

(primarily layette and certain baby apparel) within the CARTER'S, CARTER'S CLASSICS and TYKES lines. Once an annual plan has been established with an account, we place the account on our semi-monthly automatic reorder plan for "basics". Automatic reorder allows us to plan our sourcing requirements and benefits both us and our wholesale customers by maximizing our customers' in-stock positions, thereby improving sales and profitability. Our sleepwear and playclothes products are planned and ordered seasonally as new products are introduced.

RETAIL OPERATIONS

We currently operate 151 retail outlet stores in 39 states featuring our quality merchandise, complemented by select brand accessories, apparel and licensed products. Our stores, which average 5,025 square feet per location, offer a broad assortment of baby, toddler and young children's apparel including layette, sleepwear, underwear, playclothes, swimwear, outerwear and related accessories.

Business segment financial information for the wholesale and retail segments is contained in ITEM 8 "Financial Statements and Supplementary Data", Note 16--"Segment Information" to the Consolidated Financial Statements.

MARKETING

Our strategy has been to promote our brand image as the leader in baby apparel and to consistently provide quality products at a great value to consumers. To this end, we employ a disciplined marketing strategy which identifies and focuses on core products through consumer product testing. The market strategy focuses on brand and product presentation at the consumer point-of-purchase providing consistent, premium service, including delivering and replenishing products on time to fulfill customer and consumer needs.

We believe that we have strengthened our brand image with the consumer through our marketing focus on core products along with emphasis on creative artwork in prints and embroideries. We also attempt to differentiate our products through fixturing, store-in-store shops and advertising with wholesale customers. We believe that frequent meetings between our executives and senior representatives from our key wholesale customers help maintain account relationships and further strengthen our brand's image in the marketplace.

PRODUCT SOURCING

We continue to expand our global supply chain capabilities. Consistent with this strategy, since 1999 we have closed our remaining domestic manufacturing operations, including textile, printing, cutting, embroidery and sewing facilities. We also closed one offshore sewing facility. Fabric we previously produced is currently purchased from third-party manufacturers. In the United States, we currently operate three distribution centers. We operate two sewing facilities in Costa Rica and two sewing facilities in Mexico. We also source our products through contractual arrangements throughout the world.

We believe that our sourcing arrangements are sufficient to meet current and planned operating requirements and that significant additional opportunities exist to further optimize our supply chain. Such opportunities include the reduction of product costs, cycle times and inventories. We will attempt to realize these reductions through investments in advanced information systems, the expansion of global sourcing relationships, reductions in stock-keeping units and product complexity and our continued focus on core product offerings.

DEMOGRAPHIC TRENDS

Demographic and psychographic trends support strong and growing baby and young children's apparel markets and help insulate us from seasonal and fashion fluctuations. Highlights of these trends include:

- a strong birth rate;

- more money being spent on babies than ever before;

- multiple births at record levels;

- 40% of all births are first children; and

- grandparents as a growing and more affluent market.

In 2000 (the most current data available supplied by National Center for Health Statistics), 4.1 million births were reported and demographers project a progressive increase in births over the next 20 years that will ultimately surpass the original baby boom. Today's mother is more likely to be working outside the home and have more income to spend on her children's apparel. In addition, new families are being formed and higher levels of spending are required for a first child's wardrobe.

COMPETITION

The baby and young children's apparel markets are highly competitive. Competition is generally based upon product quality, brand name recognition, price, selection, service and convenience. Both branded and private label manufacturers compete in the baby and young children's markets. Our primary branded competitors include Health-Tex and Oshkosh B'Gosh, together with Disney licensed playclothes and sleepwear products, and numerous smaller branded companies. Although we believe that we do not compete directly with most private label manufacturers in sleepwear and playclothes, certain retailers, including several of our customers, have significant private label product offerings of these products. We do not believe that we have any significant branded competitors in our layette market because most of the alternative products are offered by private label manufacturers. Because of the highly fragmented nature of the industry, we also compete with several small, local manufacturers and retailers. Certain of our competitors have greater financial resources, larger customer bases and are less financially leveraged.

ENVIRONMENTAL MATTERS

We are subject to various federal, state and local laws that govern activities or operations that may have adverse environmental effects. Noncompliance with these laws and regulations can result in significant liabilities, penalties and costs. From time to time, our operations have resulted or may result in noncompliance with or liability pursuant to environmental laws. In 1998, the Lamar County (Georgia) Regional Solid Waste Authority asserted environmental claims against us related to the disposal of waste generated by one of our plants. The waste, which allegedly was contaminated, was allegedly deposited in unlined trenches at a local municipal solid waste landfill in Lamar County, Georgia during the 1970s. We paid $244,000 to settle certain of these claims in an agreement reached with the Authority on May 9, 2001. Generally, compliance with environmental laws has not had a material impact on our operations, but there can be no assurance that future compliance with such laws will not have a material adverse effect on our operations.

PATENTS, TRADEMARKS, COPYRIGHTS AND LICENSES

We own many trademarks and tradenames, including Carter's-Registered Trademark-, Carter's Growbody-Registered Trademark-, Carter-Set-Registered Trademark-, Jamakins-Registered Trademark- and Today's Classics-Registered Trademark- as well as copyrights, most of which are registered in the United States and in 60 foreign countries. Under an agreement with The Little Tikes Company, we have licensed the right to use and to sublicense the TYKES trademark for use on our products sold at Target stores. Our rights to use this trademark on our clothing products on a royalty-free basis will expire on December 31, 2003 and on toys and other products will expire on December 31, 2001. After 2003, we may continue to sell clothing products and after 2001, we may continue to sell toys and other products using the TYKES brands, although these sales will be subject to a royalty agreement with The Little Tikes Company.

We license the CARTER'S, CARTER'S CLASSICS and TYKES names along with many of our trademarks and tradenames to third-party manufacturers to produce and distribute children's apparel and related

products such as diaper bags, lamps, socks, strollers, hair accessories, outerwear, underwear, bedding, plush toys and shoes. We license the rights to John Lennon's Real Love artwork collection and the artwork of Emu Namae under agreements which expire December 31, 2003 and December 1, 2002. We have the right to exercise renewal options for the John Lennon artwork upon reaching licensing fee targets for the artwork.

EMPLOYEES

As of December 29, 2001, we had 6,083 employees, 1,824 of whom were employed on a full-time basis in our domestic operations, 1,291 of which were employed on a part-time basis in our domestic operations and 2,968 of which were employed on a full-time basis in our offshore operations. None of our employees are unionized. We have had no labor-related work stoppages and believe that our labor relations are good.

RISKS RELATING TO OUR BUSINESS

OUR DEPENDENCE ON FOREIGN SUPPLY SOURCES MAY RESULT IN DISRUPTIONS TO OUR OPERATIONS IN THE EVENT OF POLITICAL INSTABILITY OR FOREIGN REGULATIONS.

We currently source all of our sewing, embroidery, cutting and a substantial portion of our fabric production through our offshore facilities and other contractual arrangements throughout the world. We expect to continue to source more of our manufacturing and fabrics offshore over time. We may be adversely affected by:

- political instability resulting in the disruption of trade from foreign countries in which our manufacturing facilities are located; and

- the imposition of additional regulations relating to imports, duties, taxes and other charges on imports.

These and other factors could result in the interruption of production in offshore facilities or a delay in our receipt of the products in the United States. These factors may be beyond our control and may have a material adverse effect on our financial condition and results of operations.

THE LOSS OF ONE OR MORE OF OUR MAJOR SUPPLIERS FOR RAW MATERIALS MAY RESULT IN AN INTERRUPTION OF OUR SUPPLIES.

We purchase the majority of the fabrics we now source in the United States from a few vendors of each material. The loss of one or more of these suppliers could result in an interruption of supply, which could have an adverse effect on our results of operations.

WE DEPEND ON A SMALL NUMBER OF WHOLESALE CUSTOMERS AND THE LOSS OF ONE OR MORE COULD RESULT IN A MATERIAL LOSS OF REVENUES.

Approximately 74% of our total wholesale sales, excluding our off-price and discount channel sales, for fiscal 2001 were derived from sales to our top seven customers, with no one customer accounting for more than 18.0% of such sales (or more than 9.0% of our total sales) in the period. We expect that these customers will continue to represent a significant portion of our wholesale sales in the future. A significant decrease in business from one or more of these customers could result in a material adverse effect on our financial condition and results of operations.

VARIOUS GOVERNMENTAL REGULATIONS AND ENVIRONMENTAL RISKS APPLICABLE TO OUR BUSINESS MAY REQUIRE US TO TAKE ACTIONS WHICH LIMIT OUR BUSINESS AND INCREASE OUR COSTS.

Our business is subject to numerous 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

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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 have identified past non-compliance with environmental laws, including wastewater discharge and the possible discharge of other manufacturing byproducts at our textile manufacturing facility in Barnesville, Georgia. We may be required to make significant expenditures to comply with governmental laws and regulations. We cannot be certain that existing laws or regulations, as currently interpreted or reinterpreted in the future, or future laws or regulations, will not have a material adverse effect on our results of operations and financial condition.

WE OPERATE IN A HIGHLY COMPETITIVE MARKET AND OUR BUSINESS WILL SUFFER IF WE ARE UNABLE TO COMPETE EFFECTIVELY.

We operate in a highly competitive industry. The baby and young children's apparel markets are highly competitive. Competition generally is based upon product quality, brand name recognition, price, selection, service and convenience. Both branded and private label manufacturers compete in the baby and young children's apparel markets. Our primary branded competitors include Health-Tex, Baby Gap and Oshkosh B'Gosh together with Disney-licensed products in playclothes, and numerous smaller branded companies, as well as Disney-licensed products in sleepwear. Some retailers, including several that are our customers, have significant private label product offerings in playclothes. Because of the highly fragmented nature of the industry, we also compete with many small, local manufacturers and retailers. Some of our competitors have greater financial resources than we do, have larger customer bases and are less financially leveraged. As a result, these competitors or others 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.

WE MAY NOT BE ABLE TO CONTINUE TO COMPETE SUCCESSFULLY IN OUR MARKET IF WE ARE UNABLE TO ACHIEVE WIDESPREAD MARKET ACCEPTANCE OF OUR NEW PRODUCTS.

If we are unable to introduce new and innovative products that are attractive to our customers, or are unable to allocate sufficient resources to effectively market and advertise our products so that they achieve widespread market acceptance, we may not be able to compete effectively and our operating results and financial condition will be adversely affected.

THE CURRENT AND FUTURE ECONOMIC DOWNTURNS MAY ADVERSELY AFFECT OUR SALES.

A downturn in the economy may affect consumer purchases of discretionary items, which could adversely affect our sales. Our success depends on the sustained demand for our products. Many factors affect the level of consumer spending on our products, including, among others, general business conditions, interest rates, the availability of consumer credit, taxation and consumer confidence in future economic conditions. Consumer purchases of discretionary items, such as our products, tend to decline during recessionary periods when disposable income is lower. These downturns have been characterized by diminished product demand and subsequent accelerated erosion of average selling prices. A general slowdown in the economies in which we sell our products or even an uncertain economic outlook could adversely affect consumer spending on our products and, in turn, our sales and results of operations.

Since the third quarter of 2000, the U.S. economy has shown signs of a downturn, and the recent political and social turmoil, including terrorist and military actions, have put further pressure on economic conditions in the U.S. and worldwide. If this general economic slowdown continues, it may adversely impact our future business and operating results.

RETAIL TRENDS COULD RESULT IN INCREASED DOWNWARD PRESSURE ON OUR PRICES.

With the growing trend toward retail trade consolidation, we are increasingly dependent upon a reduced number of key retailers whose bargaining strength is growing. We may be negatively affected by changes in the policies of our retail trade customers, such as inventory de-stocking, limitations on access to shelf space, scan-based trading and other conditions. Further consolidations in the retail industry could result in price and other competition that could damage our business.

THE LOSS OF KEY MEMBERS OF OUR SENIOR MANAGEMENT TEAM COULD ADVERSELY AFFECT OUR BUSINESS.

Our success depends largely on the efforts and abilities of our current senior management team. Their experience and industry contacts significantly benefit us. If we were to lose the benefit of their experience and contacts, our business could be adversely affected. See "Management--Employment Arrangements."

SEASONAL FLUCTUATIONS IN THE CHILDREN'S APPAREL MARKET MAY HAVE A NEGATIVE IMPACT ON OUR BUSINESS.

We experience seasonal fluctuations in our sales and profitability, with generally lower sales and gross profit in the first and second quarters of our fiscal year. We believe that the seasonality of sales and profitability is a factor that affects the baby and young children's apparel industry generally and is due to retailer's emphasis on price reductions in the first quarter and

promotional retailers' and manufacturers' emphasis on closeouts of the prior year's product line.

OUR SUBSTANTIAL LEVERAGE COULD ADVERSELY AFFECT OUR FINANCIAL CONDITION AND PREVENT US FROM FULFILLING OUR OBLIGATIONS UNDER THE SENIOR SUBORDINATED NOTES.

We are highly leveraged. As of December 29, 2001, we had total debt of approximately $298.7 million (of which $173.7 million consisted of the senior subordinated notes, net of unamortized discount of $1.3 million, and $125.0 million consisted of secured borrowings) and common stockholder's equity of approximately $157.7 million. For the fiscal year ended December 29, 2001, our ratio of earnings to fixed charges was 1.4 to 1. In addition, we and our subsidiaries are permitted to incur substantial additional indebtedness in the future.

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

- make it more difficult for us to satisfy our obligations with respect to the senior subordinated notes;

- increase our vulnerability to general adverse economic and industry conditions;

- 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 the payment of principal of, and interest on, our indebtedness, thereby reducing the availability of such 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, the indenture and our new senior credit facility contain financial and other restrictive covenants that limit our ability to engage in activities that may be in our long-term best interests. 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 debts.

ITEM 2. PROPERTIES

We operate 151 leased retail outlet stores located primarily in outlet centers across the United States, having an average size of 5,025 square feet. Our leases have an average term of approximately five years with additional five-year renewal options. Domestically, we own three distribution facilities, two in Georgia and one in Pennsylvania. We also own three manufacturing facilities, two of which are idle and currently held for sale. We own an office building in Georgia and lease office space in four buildings--two in Georgia, one in Connecticut and one in New York. In February 2001, we entered into a ten-year lease agreement for a new corporate office in Atlanta, Georgia. Internationally, we lease two sewing facilities in Costa Rica, one in the Dominican Republic and two in Mexico. In the fourth quarter of 2001, we closed the Dominican Republic sewing facility, and our lease obligation will terminate

at the end of June 2002.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we have been involved in various legal proceedings. We believe that all of such litigation is routine in nature and incidental to the conduct of our business, and we believe that no such litigation, if resolved adversely to us, would have a material adverse effect on our financial condition or results of operations.

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

None

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

There is no established public trading market for any class of our capital stock. All of our issued and outstanding capital stock is owned by Holdings.

Our parent company, Holdings, and all of its stockholders entered into a stock purchase agreement on July 12, 2001 with a special purpose entity formed by Berkshire Partners LLC, ("Berkshire") its affiliates and associated investors to sell substantially all of the stock of Holdings (the "Acquisition"). The Acquisition closed on August 15, 2001.

We paid dividends on our common stock held by our parent, Holdings, in the amount of approximately $60,000 during the period from December 31, 2000 through August 14, 2001 ("Predecessor"). Proceeds from the dividends were used by Holdings to repurchase shares of Holdings' stock owned by one of our former employees. In addition, during the Predecessor period from December 31, 2000 through August 14, 2001, Holdings made $60,000 in capital contributions to us in connection with the issuance of shares of Holdings' stock to one of our employees. On August 15, 2001, we paid a dividend of approximately $128.6 million to Holdings. Holdings used these funds to repay debt and partially fund other payments in connection with the Acquisition, including payment to selling stockholders and option holders. Other than as described above, we have paid no dividends in fiscal years 2001 and 2000 on our common stock. We intend to retain all of our future earnings to finance our operations and do not anticipate paying cash dividends to common equity stockholders in the foreseeable future. Any decision made by our Board of Directors to declare dividends in the future will depend upon our future earnings, capital requirements, financial condition and other factors deemed relevant.
In addition, certain agreements to which we are a party restrict our ability to pay dividends on common equity (see Note 5 to the Consolidated Financial Statements).

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial and other data as of and for the five fiscal years ended December 29, 2001. As a result of certain adjustments made in connection with the Acquisition, the results of operations for the period from August 15, 2001 through December 29, 2001 (the "Successor" period) are not comparable to prior periods. The selected financial data for the five fiscal years ended December 29, 2001 were derived from our Audited Consolidated Financial Statements. Our fiscal year ends on the Saturday in December or January nearest to the last day of December.

The following table should be read in conjunction with ITEM 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and ITEM 8 "Financial Statements and Supplementary Data".

	SUCCESSOR(A)	PREDECE	
	FOR THE PERIOD FROM AUGUST 15, 2001 THROUGH DECEMBER 29, 2001	FOR THE PERIOD FROM DECEMBER 31, 2000 THROUGH AUGUST 14, 2001	2000
	(DOLLARS IN THOUSANDS)		
OPERATING DATA:			
Wholesale sales	$136,167	$160,646	$256,094
Retail sales	108,091	127,088	215,280
Total net sales	244,258	287,734	471,374
Cost of goods sold	149,352	182,863	293,340
Gross profit	94,906	104,871	178,034
Selling, general and administrative expenses	66,465	93,902	143,321
Acquisition-related non-recurring charges(b)	--	11,289	--
Writedown of long-lived assets(c)	--	3,156	--
Non-recurring charges-plant closure costs(d)	(268)	1,116	--
Royalty income	(2,624)	(4,993)	(5,808)
Operating income	31,333	401	40,521
Interest income	(207)	(73)	(303)
Interest expense	11,307	10,133	16,294
Income (loss) before income taxes, extraordinary item and cumulative effect of change in accounting principle	20,233	(9,659)	24,530
Provision for (benefit from) income taxes	7,395	(1,404)	9,731
Income (loss) before extraordinary item and cumulative effect of change in accounting principle	12,838	(8,255)	14,799
Extraordinary item, net of tax benefit of $4,115(e)	--	6,173	--
Cumulative effect of change in accounting principle, net of income tax benefit of $217(f)	--	--	354
Net income (loss)	$ 12,838	$(14,428)	$ 14,445
Net (loss) income available to common stockholder		$(16,099)	$ 11,792
Pro forma net income (loss) assuming accounting change is applied retroactively	$ 12,838	$(14,428)	$ 14,799

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BALANCE SHEET DATA (END OF PERIOD):			
Working capital(g)	$110,525		$ 84,336
Total assets	604,162		325,988
Total debt, including current maturities	298,742		141,400
Redeemable preferred stock(h)	--		19,116
Common stockholder's equity	157,715		65,397
CASH FLOW DATA:			
Net cash provided by operating activities	$ 32,656	$ 1,375	$ 26,637
Net cash used in investing activities	(13,223)	(9,266)	(19,217)
Net cash provided by (used in) financing activities	4,735	4,718	(7,138)
OTHER DATA:			
EBITDA, as defined(i)	$ 37,983	$ 28,207	$ 58,041
Gross margin	38.9%	36.4%	37.8%
Depreciation and amortization	$ 6,918	$ 12,245	$ 17,520
Capital expenditures	9,556	9,480	17,179

See Notes to Selected Financial Data.

NOTES TO SELECTED FINANCIAL DATA

(a) As a result of the Acquisition, our assets and liabilities were adjusted 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 also adopted the provisions of Statements of Financial Accounting Standards ("SFAS") No. 141 "Business Combinations" ("SFAS 141") and No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"), which affect the amortization of goodwill and other intangibles. Accordingly, the results of operations for the Successor period from August 15, 2001 through December 29, 2001 are not comparable to prior periods.

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

(c) The $3.2 million writedown 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 closed in that period. The writedown for the 1999 fiscal year represents the $6.9 million writedown in the carrying value of our textile facility assets, for which the operations were closed in December 1999, and a $0.2 million loss on property, plant and equipment related to the closures of three domestic sewing facilities.

(d) The $1.1 million plant closure non-recurring charge for the Predecessor period from December 31, 2000 through August 14, 2001 relates to closure costs associated with the two domestic manufacturing facilities closed in that period.

(e) The extraordinary item for the Predecessor period December 31, 2000 through August 14, 2001 reflects the write-off of debt issuance costs of approximately $3.3 million, net of a tax benefit of approximately $1.3 million, and a debt prepayment penalty of approximately $7.0 million, net of tax benefit of approximately $2.8 million.

(f) 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 ("SEC") Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements."

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

(h) We issued redeemable preferred stock in connection with the 1996 Investcorp acquisition of Holdings for $20.0 million, net of $2.2 million of fees associated with its issuance. This preferred stock was cancelled as part of the Acquisition as described in (a) above.

(i) As defined for presentation in the selected financial data table, EBITDA represents earnings before interest, income tax expense, depreciation and amortization and also excludes the items referred to in notes (b), (c) and (d) above. Included in EBITDA for the Successor period from August 15, 2001 through December 29, 2001, is a $4.5 million charge related to the amortization of the step-up in the inventory valuation as of the Acquisition. Included in EBITDA for the Predecessor period from December 31, 2000 through August 14, 2001, are $1.3 million of costs incurred in connection with activities leading up to the Acquisition. EBITDA, as defined above, is presented because we believe it is helpful to securities analysts, investors and other interested parties in the evaluation of companies in our industry. It is not a measurement of financial performance under generally accepted accounting principles and should not be considered as an alternative to cash flow from operating activities or as a measure of liquidity or an alternative to net income as an indicator of our operating performance or any other measures of performance derived in accordance with generally accepted accounting principles. See the "Statements of Cash Flow" included in our financial statements.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our results of operations and current financial position. You should read this discussion in conjunction with our consolidated historical financial statements and notes included elsewhere in this annual report. Our discussion of our results of operations and financial condition includes various forward-looking statements about our markets, the demand for our products and services and our future results. We based these statements on certain assumptions that we consider reasonable. For information about risks and exposures relating to our business and our company, you should read the section entitled "Risk Factors" in Item 1 of this annual report. Actual results may differ materially from those suggested by our forward-looking statements for various reasons including those discussed in the "Risk Factors" section. 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 after we file this annual report.

GENERAL

We are the largest branded marketer of baby apparel and a leading marketer of young children's apparel. We sell our products to over 420 department, specialty and discount store customers, which together accounted for 56% of our sales during fiscal 2001. We also sell our products through our 151 retail outlet stores, which accounted for 44% of our sales during fiscal 2001.

Consolidated net sales have increased from $363.0 million in 1997 to $532.0 million in 2001. This represents an average annual growth rate of 10.0%. During this period, wholesale sales have increased on average 7.8% annually, from $219.5 million to $296.8 million and retail sales have increased on average 13.2% annually, from $143.4 million to $235.2 million. The increase in wholesale sales resulted primarily from the success of product introductions and the strength of the CARTER'S brand in the market place relative to branded and private label competitors. The increase in retail sales resulted from new store openings and comparable store (stores open more than 12 months) sales increases.

Our parent company, Holdings, and all of its stockholders entered into a stock purchase agreement on July 12, 2001 with a special purpose entity formed by Berkshire Partners LLC, its affiliates and associated investors to sell substantially all of the stock of Holdings. The Acquisition closed on August 15, 2001.

In connection with the Acquisition, we issued $175.0 million of notes under a new senior subordinated loan facility and entered into an agreement for a new senior credit facility, including $125.0 million of new term loan borrowings and capacity to borrow up to $60.0 million under a revolving credit facility. In addition, Berkshire Partners and the other buyers invested capital of $145.5 million into Holdings, including an $18.3 million rollover of equity by our management. The Acquisition was accounted for as a purchase and has been reflected in our financial statements using pushdown accounting (See Note 1 to the Consolidated Financial Statements).

The 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 for purposes of the discussion below only. While this approach is not consistent with generally accepted accounting principles, due to the new basis of accounting established at the Acquisition date, management believes it is the most practical way to comment on the results of operations.

As a result of the Acquisition, our assets and liabilities were adjusted to their estimated fair values as of August 15, 2001. In addition, we entered into new financing arrangements and had a change in our capital structure. The seven and one-half month period prior to the Acquisition includes certain Acquisition-related non-recurring charges, principally sellers' expenses, such as management bonuses and professional fees, and an extraordinary charge for debt prepayment penalties and the write-off of

deferred debt issuance costs on debt retired as a result of the Acquisition and refinancing. All Predecessor periods presented included amortization expense on our tradename and goodwill. The period subsequent to the Acquisition reflects 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 142. Accordingly, the results of operations for the Predecessor and Successor periods are not comparable.

RESULTS OF OPERATIONS

The following table sets forth certain components of our Consolidated Statements of Operations data expressed as a percentage of net sales:

FISCAL YEARS

	2001	2000	1999
STATEMENTS OF OPERATIONS:			
Wholesale sales	55.8%	54.3%	55.8%
Retail sales	44.2	45.7	44.2
Net sales	100.0	100.0	100.0
Cost of goods sold	62.4	62.2	65.6
Gross profit	37.6	37.8	34.4
Selling, general and administrative expenses	30.1	30.4	30.1
Non-recurring charges	2.9	--	1.7
Royalty income	(1.4)	(1.2)	(1.0)
Operating income	6.0	8.6	3.6
Interest expense, net	4.0	3.4	4.3
Income (loss) before income taxes, extraordinary item and cumulative effect of change in accounting principle	2.0	5.2	(0.7)
Provision for (benefit from) income taxes	1.1	2.1	(0.2)
Income (loss) before extraordinary item and cumulative effect of change in accounting principle	0.9%	3.1%	(0.5)%

FISCAL YEAR ENDED DECEMBER 29, 2001 COMPARED WITH FISCAL YEAR ENDED DECEMBER 30, 2000

NET SALES. Consolidated net sales for fiscal 2001 were $532.0 million, an increase of $60.6 million, or 12.9%, compared to $471.4 million in fiscal 2000. This revenue growth was generated by strong performance across all distribution channels of our major product markets which are baby, sleepwear and playclothes. Total wholesale sales increased $40.7 million, or 15.9%, to $296.8 million in fiscal 2001 from $256.1 million in fiscal 2000. In fiscal 2001, wholesale sales, excluding discount channel and off-price sales, increased $28.3 million, or 12.1%, to $263.5 million from $235.2 million in fiscal 2000. The increase in wholesale sales during fiscal 2001 reflects the growth of baby, sleepwear and playclothes product lines of $7.5 million, or 6.3%, $9.5 million, or 10.3%, and $11.4 million, or 47.6% as compared to fiscal 2000. Strong product performance reflects improvements in fabrics, garment construction, embroideries and prints made possible through our global sourcing capabilities. Over the past two years, we have been transitioning from a domestic, vertically-integrated manufacturing company to a global sourcing company. In addition to operating leased sewing facilities in Central America and Mexico, we have built full-package sourcing capabilities, which has enabled us to source better products at lower costs than we believe are available domestically. We entered the discount channel in the fourth quarter of 2000 by launching the TYKES brand, the revenues from which were $20.9 million for fiscal 2001. This contributed to the overall increase in total wholesale sales for this period. Off-price sales, which are merchandise sold at more than 25% off regular wholesale selling prices, for fiscal 2001 decreased $4.5 million to $12.4 million from $17.0 million in fiscal 2000. Off-price sales were 2.3% of total sales in fiscal 2001 compared to 3.6% in fiscal 2000. Retail outlet store sales

increased $19.9 million, or 9.2%, in fiscal 2001 to $235.2 million from $215.3 million in fiscal 2000. This increase was attributed to strong growth of

baby, sleepwear and playclothes product lines of $6.5 million, or 15.9%, $3.8 million, or 11.1%, and $10.5 million, or 12.5% as compared to 2000. Product performance was also the driving force behind our comparable store sales increase of 6.5% in fiscal 2001. During fiscal 2001, we opened nine stores and we closed five stores. There were 151 outlet stores in operation at December 29, 2001 compared to 147 at December 30, 2000.

GROSS PROFIT. In fiscal 2001, gross profit increased $21.7 million, or 12.2%, to $199.8 million compared to $178.0 million in fiscal 2000. Gross profit as a percentage of net sales in fiscal 2001 decreased to 37.6% compared to 37.8% in fiscal 2000. The decrease in gross profit as a percentage of net sales in fiscal 2001 reflects a $4.5 million charge related to the amortization of the step-up in the inventory valuation as of the Acquisition. Excluding this Acquisition adjustment, gross profit as a percentage of net sales would have been 38.4% in fiscal 2001. This improvement in gross profit as a percentage of net sales in fiscal 2001 reflects the benefit from the change in product sourcing strategies mentioned above partially offset by a higher mix of discount channel revenues.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. In fiscal 2001, selling, general and administrative expenses increased $17.0 million, or 11.9%, to $160.4 million from $143.3 million in fiscal 2000. As a percentage of net sales, selling, general and administrative expenses decreased to 30.1% in fiscal 2001 from 30.4% in fiscal 2000. Included in selling, general and administrative expenses are $1.3 million of costs incurred in connection with activities leading up to the Acquisition. Excluding such costs, selling, general and administrative expenses relative to sales was 29.9% in fiscal 2001. The decrease in selling, general and administrative expenses as a percentage of net sales is attributed to the benefit from continued increases in comparable retail outlet store growth and lower distribution costs relative to net sales, partially offset by investments in brand marketing.

NON-RECURRING CHARGES / WRITEDOWN OF LONG-LIVED ASSETS. As described in Note 1 to the accompanying financial statements for the fiscal year ended December 29, 2001, we incurred Predecessor Acquisition-related, non-recurring 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 17 to the accompanying 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 non-recurring charge of approximately $582,000 related to certain closure costs and involuntary termination benefits. Additionally, we recorded a non-cash charge of approximately $742,000 related to the writedown of the asset value to the sewing facility's estimated net realizable value. In the second quarter of fiscal 2001, we closed our fabric printing operations located in Barnesville, Georgia and recognized a non-recurring charge of approximately $534,000 related to certain closure costs and involuntary termination benefits. Additionally, we recorded a non-cash charge of approximately $2,414,000 related to the writedown of the asset value to the printing facility's estimated net realizable value. During the Successor period, we recorded $268,000 in reductions to the estimates of closure and termination costs.

ROYALTY INCOME. Royalty income was $7.6 million and $5.8 million in fiscal years 2001 and 2000. We attribute the increase in royalty income to the extension of our brands through new licensing arrangements and an increase in average royalty rates.

OPERATING INCOME. Operating income for fiscal 2001 decreased $8.8 million, or 21.7%, to $31.7 million compared to $40.5 million in fiscal 2000. Operating income as a percentage of net sales decreased to 6.0% in fiscal 2001 from 8.6% in fiscal 2000. The decrease primarily reflects the effects of the Predecessor

non-recurring Acquisition-related charges, plant closure costs and other costs incurred in connection with the Acquisition.

INTEREST EXPENSE. Interest expense for fiscal 2001 increased $5.1 million, or 31.6%, to $21.4 million from $16.3 million in fiscal 2000. Average daily revolver borrowings in fiscal 2001 were $5.9 million compared to $5.0 million in fiscal 2000. We attribute these increases primarily to additional borrowings resulting from the Acquisition and refinancing. Prior to the Acquisition, interest expense for the Predecessor period from December 31, 2000 through August 14, 2001 was approximately $10.1 million, an amount comparable to similar periods in 2000. At December 29, 2001, outstanding debt aggregated $298.7 million compared to $141.4 million at December 30, 2000. Included in the outstanding debt at December 29, 2001 of $298.7 million was $125.0 million which bore interest at a variable rate, so that an increase of 1% in the applicable rate would increase our annual interest cost by $1,250,000. At December 29, 2001, there were no borrowings under our $60.0 million revolving credit facility. We had outstanding letters of credit totaling $6.5 million as of December 29, 2001.

INCOME TAXES. Our effective tax rate was 36.5% for the Successor period from August 15, 2001 through December 29, 2001; 14.5% for the Predecessor period from December 31, 2000 through August 14, 2001; and 39.7% for fiscal 2000. The 14.5% benefit against our pretax loss for the Predecessor period is primarily a result of goodwill amortization and certain seller's expenses incurred in connection with the Acquisition that are not deductible for tax purposes. We expect our future effective tax rate to approximate that of the Successor period.

EXTRAORDINARY ITEM. As described in Note 1 to the accompanying financial statements, in connection with the Acquisition and refinancing, we incurred an extraordinary loss of $6.2 million (net of tax) during the Predecessor period from December 31, 2000 through August 14, 2001 due to the write-off of deferred debt issuance costs and debt prepayment penalties.

NET (LOSS) INCOME. Our fiscal 2001 pre-tax income was $10.6 million, as compared to $24.5 million in fiscal 2000. As noted above, fiscal 2001 includes a $4.5 million charge related to amortization of the step-up in the inventory valuation as of the Acquisition, $1.3 million of costs incurred in connection with activities leading up to the Acquisition, $11.3 million of Acquisition-related non-recurring charges and $4.0 million of non-recurring plant closure and asset impairment charges. Excluding these items, our fiscal 2001 pre-tax income would have been $31.7 million. As noted above, our fiscal 2001 net loss was $1.6 million and included an Acquisition-related extraordinary charge of $6.2 million, net of tax. Excluding these non-recurring and Acquisition-related charges, our 2001 net income would have been approximately $20.4 million, as compared to net income of $14.4 million in fiscal 2000.

FISCAL YEAR ENDED DECEMBER 30, 2000 COMPARED WITH FISCAL YEAR ENDED JANUARY 1, 2000

NET SALES. Net sales for fiscal 2000 increased 13.7% to $471.4 million from $414.6 million in fiscal 1999. This increase includes a 10.7% increase in wholesale sales and a 17.4% increase in retail sales. Revenues from each of our major product markets, which are baby, sleepwear and playclothes, increased $18.8 million, or 12.0%, $20.4 million, or 18.2%, and $8.6 million, or 8.7%, from 1999 to 2000. Our total wholesale sales for fiscal 2000 increased to $256.1 million from $231.3 million in fiscal 1999. Excluding off-price and Tykes sales, wholesale sales increased $26.3 million, or 12.6%, to $235.2 million in 2000 from $208.9 million in 1999. The increase in wholesale sales reflects the

growth of baby and sleepwear product lines of $14.7 million, or 14.1%, and $17.0 million, or 22.7%, as compared to fiscal 1999. Our continued success with these lines results from improvements made through our new product sourcing strategy and our focus on product innovation through creative prints and embroideries. Included in 2000 wholesale sales was $4.0 million in sales of TYKES products sold in an initial launch in the discount channel. Wholesale sales in 2000 included a lower mix of off-price sales (merchandise promoted at more than 25% off regular wholesale selling prices) to the secondary market. Off-price sales as a percentage of consolidated sales in 2000 were 3.6% compared to 5.4% in 1999. This decrease in off-price sales reflects the benefit achieved from improved product development and inventory management disciplines. Our retail sales for fiscal 2000 increased to $215.3 million from $183.3 million in fiscal 1999. We attribute this increase to the strong performance of our playclothes product line. Product performance was also the driving force behind the comparable store sales increase in retail store sales of 14.3% in 2000. In 2000, we opened seven stores and closed six stores. We had 147 stores in operation at December 30, 2000 compared to 146 in operation at January 1, 2000.

GROSS PROFIT. Our gross profit for fiscal 2000 increased 24.7% to $178.0 million from $142.8 million in fiscal 1999. Gross profit as a percentage of net sales in fiscal 2000 increased to 37.8% from 34.4% in fiscal 1999. We attribute the improvement in gross profit to a higher mix of retail revenues, a lower mix of off-price sales and the benefit from cost reduction achieved through increased

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levels of global sourcing. In 1999, we curtailed production and ultimately closed our textile facility, which had produced substantially all of our fabrics. Gross profit in 1999 was negatively impacted by costs associated with this closure and the closure of three of our sewing facilities in the United States. We achieved a favorable impact on our fiscal 2000 numbers as a result of the successful transition to outsourcing 100% of our fabric requirements and the further movement of sewing production to our offshore facilities and to various third parties.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Our selling, general and administrative expenses for fiscal 2000 increased 14.7% to $143.3 million from $125.0 million in fiscal 1999. Selling, general and administrative expenses as a percentage of our net sales were 30.4% in fiscal 2000 compared to 30.1% in fiscal 1999. The increase in selling, general and administrative expenses includes the variable costs required to support higher revenue levels, investments in brand marketing and retail partnerships and provisions for incentive compensation.

ROYALTY INCOME. Royalty income was $5.8 million and $4.2 million in fiscal years 2000 and 1999. We attribute the increase in royalty income to the extension of our brands through new licensing arrangements and an increase in average royalty rates.

OPERATING INCOME. Operating income for fiscal 2000 increased to $40.5 million from $14.9 million in fiscal 1999. Operating income as a percentage of net sales increased to 8.6% in fiscal 2000 from 3.6% in fiscal 1999. This increase reflects the net effect of changes in gross profit and selling, general and administrative expenses as described above.

INTEREST EXPENSE. Our interest expense for fiscal 2000 decreased to $16.3 million from $17.7 million in fiscal 1999. This decrease reflects our lower interest expense on lower average borrowings under our revolving credit facility. Average daily revolver borrowings in 2000 decreased to $5.0 million from $25.3 million in 1999. Lower average borrowings were due primarily to lower average gross inventory levels, which resulted from improved inventory

management disciplines. In fiscal 2000, we earned approximately $303,000 in interest income from overnight investments. At December 30, 2000, our outstanding debt aggregated $141.4 million, of which $41.4 million bore interest at a variable rate, so that an increase of 1% in the applicable rate would increase our annual interest cost by $414,000. At December 30, 2000, there were no borrowings under our $65.0 million revolving credit facility. We had outstanding letters of credit totaling $6.0 million as of December 30, 2000.

INCOME TAXES. Our 2000 effective tax rate of 39.7% was more than the prior year's effective tax rate of 30.0% due to the effect of permanent tax differences, primarily goodwill amortization. In 1999, such permanent differences reduced the tax benefit related to the pre-tax operating loss.

NET INCOME (LOSS). Primarily as a result of the factors described above, we reported net income of $14.4 million in fiscal 2000 compared to a net loss of $(2.0) million in fiscal 1999.

LIQUIDITY AND CAPITAL RESOURCES

Our primary cash needs are working capital, capital expenditures and debt service. Historically, we have financed these needs primarily through internally generated cash flow and funds borrowed under a senior credit facility. Our primary source of liquidity will continue to be cash flow from operations and borrowings under our credit facilities, and we expect that these sources will fund our ongoing requirements for debt service and capital expenditures. These sources of liquidity may be impacted by continued demand for our products and our ability to meet debt covenants under our credit facility.

Net accounts receivable at December 29, 2001 were $35.4 million compared to $33.8 million at December 30, 2000. This increase reflects a higher level of wholesale shipments in the latter part of the fourth quarter ended December 29, 2001 compared to the comparable period in 2000.

Net cash provided by operating activities during fiscal 2001 and fiscal 2000 was approximately $34.0 million and $26.6 million. This increase is primarily attributed to net changes in inventory balances offset by the payments of certain Acquisition-related expenses. Inventory levels decreased to

$89.1 million at December 29, 2001 from $92.4 million at fiscal year end 2000. Net cash provided by our operating activities in fiscal year 1999 was $38.9 million. The decrease in net cash flow provided by operating activities in fiscal 2000 from fiscal 1999 is attributed to investments in inventory required to support higher revenue levels.

We invested $19.0 million, $17.2 million and $12.7 million in capital expenditures during fiscal years 2001, 2000 and 1999. We plan to invest approximately $20.0 million in capital expenditures in fiscal 2002. Major areas for investment include retail outlet store openings and remodeling and fixturing programs for wholesale customers.

Concurrent with the Acquisition, we repaid all of our outstanding $51.6 million of borrowings under our old senior credit facility and redeemed all $100.0 million principal amount of our outstanding senior subordinated notes. We issued $175.0 million of 10.875% senior subordinated notes due 2011 (the "Notes") for $173.7 million in proceeds and entered into a new senior credit facility with term loan and revolving loan facilities. The term loan facility provides for a term loan in the principal amount of $125.0 million. The revolving credit facility will provide revolving loans in an aggregate amount of up to $60.0 million. Upon consummation of the Acquisition, we increased our level of indebtedness by borrowing the full amount available under the term loan

facility and $24.0 million under the revolving credit facility. At December 29, 2001, we had approximately $298.7 million of debt outstanding, consisting of $173.7 million of Notes, $125.0 million in term loan borrowings and no revolver borrowings under the senior credit facility, exclusive of approximately $6.5 million of outstanding letters of credit. At December 29, 2001 we had approximately $53.5 million of financing available under our revolving loan facility. The borrowings under the revolving credit facility will be available to fund our working capital requirements, capital expenditures and other general corporate purposes.

Principal borrowings under the term loan are due and payable in twenty-four quarterly installments of approximately $.313 million beginning December 31, 2001 through September 30, 2007 and four quarterly payments of approximately $29.4 million from December 31, 2007 through September 30, 2008. Interest on the term loan is payable at the end of interest rate reset periods, which vary in length but in no case exceed six months. The outstanding balance of the revolving credit facility is payable in full on August 15, 2006, and interest is payable quarterly. No principal payments are required on the Notes prior to their scheduled maturity. Interest is payable semi-annually on the Notes in February and August of each year, commencing February 15, 2002, in the amount of $9.5 million for each payment.

In connection with the Acquisition, we entered into a management agreement with Berkshire Partners LLC. Under this agreement, we will pay Berkshire Partners an annual management fee of $1.65 million commencing on the first anniversary of the Acquisition. We will pay this fee quarterly in advance. In addition, upon consummation of the Acquisition, we paid Berkshire Partners an acquisition fee of $2.0 million. We have agreed to pay Berkshire Partners an acquisition fee of 1% of any future financing or 1% of the value of any acquisition for their advice in connection with any future financing or acquisition.

The following table summarizes the maturity or expiration dates of financial obligations and commitments for the following fiscal years ($000):

	2002	2003	2004	2005	2006	THE
Long-term debt......................	$ 1,250	$ 1,563	$ 1,250	$ 1,250	$ 937	$2
Capital lease obligations (see Note 11 to the Consolidated Financial Statements)......................	501	--	--	--	--	
Operating leases (see Note 11 to the Consolidated Financial Statements)......................	16,311	13,614	11,275	8,808	5,166	
Total financial obligations........	18,062	15,177	12,525	10,058	6,103	3
Letters of credit..................	6,506	--	--	--	--	
Management fee.....................	619	2,063	1,650	1,650	618	
Total financial obligations and commitments....................	$25,187	$17,240	$14,175	$11,708	$6,721	$3

On May 1, 2001 we paid a semi-annual dividend of 12% on $20.0 million of redeemable preferred stock, or approximately $1.2 million, to Holdings. This preferred stock was cancelled in connection with the Acquisition.

At the Acquisition, we also paid a dividend of approximately $128.6 million to Holdings. Holdings used these funds to repay debt and partially fund other payments in connection with the Acquisition, including payments to selling stockholders and option holders.

Based on our current level of operations and anticipated cost savings and operating improvements, we believe that cash generated from operations and available cash, together with amounts available under the revolving credit portion of our new senior credit facility, will be adequate to meet our debt service requirements, capital expenditures and working capital needs for the foreseeable future, although no assurance can be given in this regard. We may, however, need to refinance all or a portion of the principal amount of the Notes on or prior to maturity.

The senior credit facility imposes certain covenants, requirements and restrictions on actions by us and our subsidiaries that, among other things, restrict the payment of dividends (see Note 5 to the Consolidated Financial Statements).

IMPACT OF THE ACQUISITION

As a result of the Acquisition, we adjusted our assets and liabilities to their fair value as of the Acquisition date. We also increased our aggregate borrowings in connection with our new financing arrangements. Accordingly, our depreciation expense will be lower and our amortization and interest expenses will be higher in periods following the Acquisition. We allocated a significant portion of the purchase price to our tradename. As an asset with an indefinite life, we will not amortize this asset unless and until we determine it has a definite life, but it will be subject to an annual impairment review. We have allocated the excess of the total purchase price over the value of our net assets at closing to goodwill, and it will be subject to an annual impairment review.

In connection with the Acquisition, we reevaluated the requirements for certain manufacturing operations, which we had previously planned to maintain to support our long-term revenue growth plans. After a thorough assessment of alternative sourcing opportunities, we decided to exit certain manufacturing operations. We made this decision in connection with our new ownership in advance of the Acquisition. Accordingly, we have closed one offshore and two domestic manufacturing facilities at the end of fiscal 2001. In addition to lowering inventory levels, we expect our sourcing strategy to further streamline operations by allowing us to take advantage of sources of supply nearer to our current offshore locations, as well as to expand the use of lower cost third-party full-packaging suppliers. Also in connection with the Acquisition and new ownership, we have determined to abandon an initiative to open a new line of retail stores. This has led us to dismiss some of our employees and

to terminate a major consulting contract. The allocation of the purchase price includes approximately $2.9 million in exit costs associated with the above decisions.

EFFECTS OF INFLATION

We are affected by inflation and changing prices primarily through the purchase of raw materials, increased operating costs and expenses and higher interest rates. The effects of inflation in changing prices on our net sales, revenues and operations have not been material in recent years.

SEASONALITY

We experience seasonal fluctuations in our sales and profitability, with generally lower sales and gross profit in the first and second quarters of our fiscal year. We believe that the seasonality of sales and profitability is a factor that affects the baby and children's apparel industry generally and is primarily due to retailers' emphasis on price reductions in the first quarter and promotional retailers' and manufacturers' emphasis on closeouts of the prior year's product lines.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, intangible assets, income taxes, restructuring, pensions and other post-retirement benefits, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Financial Reporting Release No. 60, which was recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 to the Consolidated Financial Statements, included elsewhere in this Form 10-K, includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods used by us.

REVENUE RECOGNITION: We recognize wholesale revenue after shipment of products to customers, when title passes and when all risks and rewards of ownership have transferred. As discussed in Note 1 to the Consolidated Financial Statements, in certain cases, this does not occur until the goods reach the specified customer. We consider revenue realized or realizable and earned when the product has been shipped, the sales price is fixed or determinable and collectibility is reasonably assured. In the normal course of business, we grant certain accommodations and allowances to our wholesale customers. Such amounts are included in selling, general and administrative expenses. Retail store revenues are recognized at the point of sale. We reduce revenue for customer returns and deductions. We also maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, an additional allowance could be required.

INVENTORY: We write down our inventory for estimated excess and obsolescence equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by us, additional write-downs may be required.

GOODWILL AND TRADENAME: As of December 29, 2001, we have recorded approximately $359 million in goodwill and tradename assets. The fair value of the Carter's tradename was estimated to be

approximately $220 million using a discounted cash flow analysis which examined the hypoythetical cost savings that accrue as a result of our ownership of the tradename. The cash flows, which incorporated both historical and projected financial performance, were discounted using a discount rate of ten percent. The tradename was determined to have an indefinite life. The carrying value of these assets will be subject to annual impairment reviews based on the estimated fair values of the underlying businesses. These estimated fair values are based on estimates of the future cash flows of the businesses. Factors affecting these future cash flows include the continued market acceptance of our offered products and the development of new products. Impairment reviews may also be triggered by any significant events or changes in circumstances.

RECENT ACCOUNTING PRONOUNCEMENTS

In 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133--An Amendment of FASB Statement No. 133." Provisions of SFAS 133 were effective as of the beginning of fiscal 2001. SFAS 133 establishes accounting and reporting standards requiring that all derivative instruments, including certain derivative instruments embedded in other contracts, be recorded in the balance sheet as either assets or liabilities measured at fair value. SFAS 133 requires that changes in the derivative instrument's fair value be recognized currently in earnings, unless specific hedge accounting criteria are met. SFAS 133 did not have a material impact on our financial position or our results of operations at the required adoption date or as of December 29, 2001 and the period then ended.

In July 2001, the FASB issued SFAS 141 "Business Combinations" and SFAS 142 "Goodwill and Other Intangible Assets." SFAS 141 supercedes Accounting Principles Board Opinion ("APB") No. 16, "Business Combinations." The most significant changes made by SFAS 141 are: (1) requiring that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, (2) establishing specific criteria for the recognition of intangible assets separately from goodwill and (3) requiring unallocated negative goodwill to be written off immediately as an extraordinary gain (instead of being deferred and amortized).

SFAS 142 supercedes APB No. 17, "Intangible Assets." SFAS 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their acquisition (i.e., the post-acquisition accounting). The most significant changes made by SFAS 142 are: (1) goodwill and indefinite lived intangible assets will no longer be amortized, (2) goodwill will be tested for impairment at least annually at the reporting unit level, (3) intangible assets deemed to have an indefinite life will be tested for impairment at least annually and (4) the amortization period of intangible assets with finite lives will no longer be limited to forty years. The provisions of SFAS 142 are effective for fiscal years beginning after December 15, 2001 and must be adopted at the beginning of a fiscal year. However, goodwill and intangible assets acquired after June 30, 2001 are subject immediately to the non-amortization and amortization provisions of this statement.

Prior to the Aquisition, our tradename and goodwill arising from the 1996 acquisition were being amortized on a straight-line basis over estimated lives of 40 years. However, in connection with the Acquisition, we have adopted the provisions of SFAS 141 and have applied the required provisions of SFAS 142.

Accordingly, our tradename and goodwill have now been deemed to have indefinite lives and are no longer being amortized in the Successor period. Our licensing agreements, however, have been recognized in the allocation of the Acquisition purchase price and will be amortized over the average three-year life of such agreements, as it has been determined that these agreements have finite lives.

We adopted the remaining provisions of SFAS 142 effective December 30, 2001 (fiscal 2002). In accordance with SFAS 142, we are required to measure our goodwill for impairment on at least an annual basis by comparing the fair value of our reporting units, as defined by SFAS 142, to their

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respective carrying value. We are required to identify our reporting units by the end of the first quarter of fiscal 2002 and complete the initial impairment analysis by the end of the second quarter of fiscal 2002. In accordance with SFAS 142, we are required to assess the carrying value of our tradename for impairment by the end of the first quarter of fiscal 2002. In addition to the annual tests, our goodwill and tradename will be tested for impairment if events or changes in circumstances indicate that either of these assets might be impaired.

Prior to the implementation of SFAS 142, amortization of our tradename and goodwill amounted to approximately $3.2 million on an annual basis. Accumulated amortization of the tradename at December 30, 2000 was $10,417,000. Accumulated amortization of goodwill at December 30, 2000 was $3,478,000.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 requires recording the fair market value of an asset retirement obligation as a liability in the period in which a legal obligation associated with the retirement of tangible long-lived assets is incurred. The statement also requires recording the contra asset to the initial obligation as an increase to the carrying amount of the related long-lived asset and depreciation of that cost over the life of the asset. We would be required to adopt the provisions of SFAS 143 in fiscal 2003; however, SFAS 143 is not expected to have an impact on our financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The statement also extends the reporting requirements to report separately, as discontinued operations, components of an entity that have either been disposed of or classified as held for sale. We will adopt the provisions of SFAS 144 as of the beginning of fiscal 2002. Such adoption is not expected to have a significant effect on our financial statements.

In November 2001, the Financial Accounting Standards Board's Emerging Issues Task Force ("EITF") issued EITF Issue No. 01-09 ("EITF 01-09"), "Accounting for Consideration Given by a Vendor to a Customer/Reseller," which addresses the accounting for consideration given by a vendor to a customer including both a reseller of the vendor's products and an entity that purchases the vendor's products from a reseller. EITF 01-09 also codifies and reconciles related guidance issued by the EITF including EITF Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products," and EITF Issue No. 00-14, "Accounting for Certain Sales Incentives." EITF 01-09 outlines the presumption that consideration given by a vendor to a customer, a reseller or a customer of a reseller is to be treated as a reduction of revenue. Treatment of such payments as an expense would only be appropriate if two conditions are met: (a) the vendor receives an identifiable benefit in return for the consideration paid that is sufficiently separable from the sale such that the vendor could have entered into an exchange transaction with a party other than the purchaser of its products in order to receive that benefit

and (b) the vendor can reasonably estimate the fair value of that benefit. We currently account for accommodations and cooperative advertising allowances made to wholesale customers as selling expenses at the point at which we enter into such commitments. Adoption of EITF 01-09 guidance will require us to reclassify certain expenses from selling, general and administrative expenses to a reduction of sales. These reclassifications will take place in the first quarter of 2002, and prior periods will be reclassified for comparative purposes. The effect of these reclassifications as it relates to customer accommodations is expected to decrease net sales by approximately $5,873,000 in the Successor period from August 15, 2001 through December 29, 2001, approximately $1,625,000 in the Predecessor period from December 31, 2000 through August 14, 2001, $3,690,000 in the Predecessor year ended December 30, 2000 and $2,993,000 in the Predecessor year ended January 1, 2000. Cooperative advertising amounted to approximately $2,605,000 in the Successor period from August 15, 2001 through December 29, 2001, approximately $3,382,000 in the Predecessor period from December 31, 2000 through August 14, 2001, $4,309,000 in the Predecessor year ended December 30, 2000 and $4,679,000 in the Predecessor year ended January 1, 2000. We are in the

process of determining the appropriate classification of such expenses as required by EITF 01-09. These reclassifications will not impact net income.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the operation of our business, we have market risk exposures to global sourcing, raw material prices and interest rates. Each of these risks and our strategies to manage the exposure is discussed below.

We currently source substantially all of our production from our offshore operations and third-party manufacturers located in foreign countries. As a result, we may be adversely affected by political instability resulting in the disruption of trade from foreign countries, the imposition of additional regulations relating to imports, duties, taxes and other charges on imports, any significant decreases in the value of the dollar against foreign currencies and restrictions on the transfer of funds. These and other factors could result in the interruption of production in offshore facilities or a delay in our receipt of the products in the United States. Our future performance may be subject to such factors, which are beyond our control, and there can be no assurance that such factors would not have a material adverse effect on our financial condition and results of operations.

Additionally, we enter into various purchase order commitments with full package suppliers. We can cancel these arrangements, although in some instances, we may be subject to a termination charge reflecting a percentage of work performed prior to cancellation.

The principal raw materials we use are finished fabrics and trim materials. These materials are available from a number of suppliers. Changes in market demand affect prices for these materials, and there can be no assurance that prices for these and other raw materials will not increase in the near future.

Our operating results are subject to risk from interest rate fluctuations on debt, which carries variable interest rates. At December 29, 2001, outstanding debt aggregated $298.7 million, of which $125.0 million bore interest at a variable rate, so that an increase of 1% in the applicable rate would increase our annual interest cost by $1,250,000 and could have an adverse effect on our net income and cash flow.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

THE WILLIAM CARTER COMPANY
(A WHOLLY-OWNED SUBSIDIARY OF CARTER HOLDINGS, INC.)
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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholder of
The William Carter Company:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and changes in common stockholder's equity present fairly, in all material respects, the consolidated financial position of The William Carter Company and its subsidiaries (the "Company") as of December 29, 2001 ("Successor," as defined in Note 1) and December 30, 2000 ("Predecessor," as defined in Note 1), and the consolidated results of their operations and their cash flows for the period from August 15, 2001 through December 29, 2001 (Successor) and the period from December 31, 2000 through August 14, 2001 (Predecessor) and for the years ended December 30, 2000 (Predecessor) and January 1, 2000 (Predecessor), in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards

generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As explained in Note 1 to the financial statements, controlling ownership of the Company's parent, Carter Holdings, Inc., was acquired in a purchase transaction as of August 15, 2001. The acquisition was accounted for as a purchase and, accordingly, the purchase price was allocated to the assets and liabilities of the Predecessor based upon their estimated fair value at August 15, 2001. Accordingly, the financial statements of the Successor are not comparable to those of the Predecessor.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for revenue recognition in fiscal 2000.

/s/ PricewaterhouseCoopers LLP

Stamford, Connecticut
February 20, 2002

THE WILLIAM CARTER COMPANY
(A WHOLLY-OWNED SUBSIDIARY OF CARTER HOLDINGS, INC.)
CONSOLIDATED BALANCE SHEETS
(DOLLARS IN THOUSANDS)

	SUCCESSOR, AT DECEMBER 29, 2001
ASSETS	
Current assets:	
Cash and cash equivalents	$ 24,692
Accounts receivable, net of allowance for doubtful accounts of $1,673 in 2001 and $2,045 in 2000	35,386
Inventories, net	89,069
Prepaid expenses and other current assets	5,585
Assets held for sale	875
Deferred income taxes	9,371
Total current assets	164,978
Property, plant and equipment, net	46,503
Assets held for sale	600
Tradename, net in 2000	220,233
Cost in excess of fair value of net assets acquired, net in 2000	139,472
Licensing agreements, net	13,125
Deferred debt issuance costs, net	12,879
Other assets	6,372
Total assets	$604,162
LIABILITIES AND STOCKHOLDER'S EQUITY	

Current liabilities:	
Current maturities of long-term debt	$ 1,250
Accounts payable	18,765
Other current liabilities	34,438
Total current liabilities	54,453
Long-term debt	297,492
Deferred income taxes	84,375
Other long-term liabilities	10,127
Total liabilities	446,447
Commitments and contingencies	
Redeemable preferred stock, par value $.01 per share; $4,000 per share liquidation and redemption value, 5,000 shares authorized, issued and outstanding in 2000	--
Common stockholder's equity:	
Common stock, par value $.01 per share; 200,000 shares authorized, 1,000 shares issued and outstanding at December 29, 2001 (Successor); 300,000 shares authorized, 1,000 shares issued and outstanding at December 30, 2000 (Predecessor)	--
Additional paid-in capital	144,877
Retained earnings	12,838
Total common stockholder's equity	157,715
Total liabilities and stockholder's equity	$604,162

The accompanying notes are an integral part of the consolidated financial statements.

THE WILLIAM CARTER COMPANY
(A WHOLLY-OWNED SUBSIDIARY OF CARTER HOLDINGS, INC.)
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLARS IN THOUSANDS)

	SUCCESSOR	PREDECESSOR	
	FOR THE PERIOD FROM AUGUST 15, 2001 THROUGH DECEMBER 29, 2001	FOR THE PERIOD FROM DECEMBER 31, 2000 THROUGH AUGUST 14, 2001	FOR THE YEARS DECEMBER 30, 2000
Net sales	$244,258	$287,734	$471,374
Cost of goods sold	149,352	182,863	293,340
Gross profit	94,906	104,871	178,034
Selling, general and administrative			

expenses	66,465	93,902	143,321
Acquisition-related non-recurring charges	--	11,289	--
Writedown of long-lived assets	--	3,156	--
Non-recurring charges-plant closure costs	(268)	1,116	--
Royalty income	(2,624)	(4,993)	(5,808)
Operating income	31,333	401	40,521
Interest income	(207)	(73)	(303)
Interest expense	11,307	10,133	16,294
Income (loss) before income taxes, extraordinary item and cumulative effect of change in accounting principle	20,233	(9,659)	24,530
Provision for (benefit from) income taxes	7,395	(1,404)	9,731
Income (loss) before extraordinary item and cumulative effect of change in accounting principle	12,838	(8,255)	14,799
Extraordinary item, net of tax benefit of $4,115	--	6,173	--
Cumulative effect of change in accounting principle, net of income tax benefit of $217	--	--	354
Net income (loss)	$ 12,838	(14,428)	14,445
Dividend requirements and accretion on redeemable preferred stock		(1,671)	(2,653)
Net (loss) income applicable to common stockholder		$(16,099)	$ 11,792
Pro forma amounts assuming the accounting change is applied retroactively:			
Net income (loss)	$ 12,838	$(14,428)	$ 14,799

The accompanying notes are an integral part of the consolidated financial statements.

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THE WILLIAM CARTER COMPANY
(A WHOLLY-OWNED SUBSIDIARY OF CARTER HOLDINGS, INC.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)

	SUCCESSOR	PRED
	FOR THE PERIOD FROM AUGUST 15, 2001 THROUGH DECEMBER 29, 2001	FOR THE PERIOD FROM DECEMBER 31, 2000 THROUGH AUGUST 14, 2001
Cash flows from operating activities:		
Net income (loss)	$ 12,838	$(14,428)

Extraordinary loss, net of taxes..................	--	6,173
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization...................	6,918	12,245
Amortization of debt issuance costs.............	593	848
Amortization of debt discount...................	49	--
(Payment of) provision for Acquisition-related non-recurring charges.........................	(11,289)	11,289
Non-recurring charges-plant closure costs........	(268)	1,116
Writedown of long-lived assets..................	--	3,156
(Gain) loss on disposal of assets...............	(38)	--
Deferred tax provision (benefit)................	2,911	(1,659)
Effect of changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable.....	4,184	(5,782)
Decrease (increase) in inventories............	21,150	(13,253)
(Increase) decrease in prepaid expenses and other assets..............................	(3,000)	1,807
(Decrease) increase in accounts payable and other liabilities..........................	(1,392)	(137)
Net cash provided by operating activities....	32,656	1,375
Cash flows from investing activities:		
Capital expenditures.............................	(9,556)	(9,480)
Proceeds from sale of property, plant and equipment......................................	218	10
Proceeds from assets held for sale................	--	204
Payment of buyer's Acquisition costs..............	(3,885)	--
Issuance of loan..................................	--	--
Proceeds from loan................................	--	--
Net cash used in investing activities........	(13,223)	(9,266)
Cash flows from financing activities:		
Proceeds from Predecessor revolving line of credit..	--	53,500
Payments of Predecessor revolving line of credit...	(12,900)	(40,600)
Proceeds from Successor revolving line of credit...	35,350	--
Payments of Successor revolving line of credit.....	(35,350)	--
Proceeds from Successor term loan.................	125,000	--
Payments of Predecessor term loan.................	(38,700)	(2,700)
Proceeds from issuance of Successor 10.875% Senior Subordinated Notes............................	173,693	--
Payment of Predecessor 10 3/8% Senior Subordinated Notes...	(100,000)	--
Borrowings on capital leases......................	--	--
Payments of capital lease obligation..............	(328)	(642)
Acquisition-related dividend to Holdings..........	(128,559)	--
Payments of other dividends to Holdings...........	--	(60)
Payments of preferred stock dividends.............	--	(1,207)
Payments of Successor debt issuance costs..........	(13,471)	--
Other..	--	(3,573)
Net cash provided by (used in) financing activities...............................	4,735	4,718
Net increase (decrease) in cash and cash equivalents.......................................	24,168	(3,173)
Cash and cash equivalents at beginning of period.....	524	3,697
Cash and cash equivalents at end of period..........	$ 24,692	$ 524

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The accompanying notes are an integral part of the consolidated financial statements.

THE WILLIAM CARTER COMPANY
(A WHOLLY-OWNED SUBSIDIARY OF CARTER HOLDINGS, INC.)

CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY

(DOLLARS IN THOUSANDS)

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (ACCUMULATE DEFICIT)
PREDECESSOR:			
BALANCE AT JANUARY 2, 1999	$ --	$ 56,811	$ 1,928
Capital contributions from Holdings		60	
Accrued dividends and accretion on redeemable preferred stock		(2,653)	
Other dividends		(507)	
Net loss			(2,024)
BALANCE AT JANUARY 1, 2000	--	53,711	(96)
Capital contributions from Holdings		60	
Accrued dividends and accretion on redeemable preferred stock			(2,653)
Other dividends			(70)
Net income			14,445
BALANCE AT DECEMBER 30, 2000	--	53,771	11,626
Capital contributions from Holdings		60	
Accrued dividends and accretion on redeemable preferred stock		(1,671)	
Other dividends		(60)	
Net loss			(14,428)
BALANCE AT AUGUST 14, 2001	$ --	$ 52,100	$(2,802)
SUCCESSOR:			
BALANCE AT AUGUST 15, 2001	$ --	$144,877	$ --
Net income			12,838
BALANCE AT DECEMBER 29, 2001	$ --	$144,877	$12,838

The accompanying notes are an integral part of the consolidated financial statements.

THE WILLIAM CARTER COMPANY
(A WHOLLY-OWNED SUBSIDIARY OF CARTER HOLDINGS, INC.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1--THE COMPANY:

The William Carter Company ("Carter's," "we," "us" and "our") is a wholly-owned subsidiary of Carter Holdings, Inc. ("Holdings"). Holdings has no significant assets or investments other than the shares of stock of The William Carter Company. On July 12, 2001, a special purpose entity formed by Berkshire Partners LLC and affiliates ("Berkshire") entered into a stock purchase agreement with Holdings and all of Holdings' stockholders to acquire substantially all of the stock of Holdings except for some equity interests held by our management (the "Acquisition"). The Acquisition was consummated on August 15, 2001. Financing for the Acquisition and related transactions totaled $468.2 million and was provided by: $24.0 million in new revolving credit facility borrowings; $125.0 million in new term loan borrowings (both the revolver and term loan are part of a $185.0 million new senior credit facility entered into by us); $173.7 million of borrowings under a new senior subordinated loan facility (issued by us in connection with an August 15, 2001 private placement); and $145.5 million of capital invested by affiliates of Berkshire and other investors, which includes rollover equity by our management of $18.3 million.

The proceeds of the Acquisition and financing were used to purchase existing equity of Holdings ($252.5 million), pay for selling stockholders transaction expenses ($19.1 million, including $0.8 million in debt prepayment penalties recorded on Holdings), pay for buyers' transaction expenses ($4.0 million), pay debt issuance costs ($13.4 million) and to retire all outstanding balances on ours and Holdings' 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. Portions of these payments were accomplished via an intercompany dividend of $128.6 million from us to Holdings. Also in connection with the Acquisition, our redeemable preferred stock held by Holdings was cancelled.

For purposes of identification and description, we are referred to as the "Predecessor" for the period prior to the Acquisition, the "Successor" for the period subsequent to the Acquisition and "we" or "us" for both periods.

The Acquisition was accounted for as a purchase and has been reflected in our financial statements using pushdown accounting. Accordingly, the purchase price for the Acquisition, including related fees and expenses, has been allocated to our tangible and identifiable intangible assets and liabilities based upon their estimated fair values with the remainder allocated to goodwill.

NOTE 1--THE COMPANY: (CONTINUED)

A summary of the total purchase price is as follows ($000):

Total purchase price	$468,193
Less-amounts retained at Holdings	(623)

	$467,570
Allocated to:	
Cash and cash equivalents	$ 7,333
Accounts receivable, net	39,570
Inventories, net	110,219
Prepaid expenses and other current assets	3,525
Property, plant and equipment	42,569
Assets held for sale	930
Licensing agreements	15,000
Tradename	220,233
Cost in excess of fair value of net assets acquired	139,472
Deferred debt issuance costs	13,427
Other assets	5,432
Accounts payable	(18,340)
Other current liabilities	(25,936)
Closure and exit liabilities	(2,921)
Other long-term liabilities	(10,850)
Net deferred tax liabilities	(72,093)
	$467,570

As a result of the above, our initial capitalization as of the Acquisition date consisted of ($000):

Borrowings on new revolving credit facility	$ 24,000
Borrowings on new term loan	125,000
Borrowings under new senior subordinated note	173,693
Additional paid-in capital	144,877
Total Capitalization	$467,570

The Acquisition related non-recurring charges in the Predecessor period December 31, 2000 through August 14, 2001 reflect special compensation of $4.5 million paid to management at the closing of the Acquisition and $6.8 million for sellers' transaction costs and fees.

The extraordinary charge in the Predecessor period December 31, 2000 through August 14, 2001 reflects the write-off of deferred debt issuance costs of approximately $1,991,000, net of a tax benefit of approximately $1,327,000, and a debt prepayment penalty of approximately $4,182,000, net of a tax benefit of approximately $2,788,000.

NOTE 1--THE COMPANY: (CO