

TEMPUR PEDIC INTERNATIONAL INC
Form 10-Q
July 27, 2011

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

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2011

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from

to

Commission file number 001-31922

TEMPUR-PEDIC INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

33-1022198
(I.R.S. Employer
Identification No.)

1713 Jaggie Fox Way
Lexington, Kentucky 40511
(Address, including zip code, of principal executive offices)

Registrant's telephone number, including area code: (800) 878-8889

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.):
Yes ☐ No ☒

The number of shares outstanding of the registrant’s common stock as of July 25, 2011 was 67,095,285 shares.

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Special Note Regarding Forward-Looking Statements

This quarterly report on Form 10-Q, including the information incorporated by reference herein, contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which includes information concerning our plans; objectives; goals; strategies; future events; future revenues or performance; the impact of the macroeconomic environment in both the U.S. and internationally on sales and our business segments; investments in operating infrastructure; changes in capital expenditures; the impact of consumer confidence; litigation and similar issues; pending tax assessments; financial flexibility; the impact of initiatives to accelerate growth, expand market share and attract sales from the standard mattress market; the improvements in our Net sales; efforts to expand business within established accounts, improve account productivity, reduce costs and operating expenses and improve manufacturing productivity; initiatives to improve gross margin; the vertical integration of our business; the development, rollout and market acceptance of new products, including the success of the TEMPUR-Cloud™ collection; our ability to further invest in the business and in brand awareness; our ability to meet financial obligations and continue to comply with the terms of our credit facility, including its financial ratio covenants; effects of changes in foreign exchange rates on our reported earnings; our expected sources of cash flow; our ability to effectively manage cash; our ability to align costs with sales expectations; and other information that is not historical information. Many of these statements appear, in particular, under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in ITEM 2 of Part I of this report. When used in this report, the words “estimates,” “expects,” “anticipates,” “projects,” “plans,” “intends,” “believes” and variations of such words or similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon our current expectations and various assumptions. There can be no assurance that we will realize our expectations or that our beliefs will prove correct.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Important factors that could cause our actual results to differ materially from those expressed as forward-looking statements are set forth in this report, including under the heading “Risk Factors” under ITEM 1A of Part II of this report and under the heading “Risk Factors” under ITEM 1A of Part 1 of our annual report on Form 10-K for the year ending December 31, 2010. There may be other factors that may cause our actual results to differ materially from the forward-looking statements.

All forward-looking statements attributable to us apply only as of the date of this report and are expressly qualified in their entirety by the cautionary statements included in this report. Except as may be required by law, we undertake no obligation to publicly update or revise any of the forward-looking statements, whether as a result of new information, future events, or otherwise.

When used in this report, except as specifically noted otherwise, the term “Tempur-Pedic International” refers to Tempur-Pedic International Inc. only, and the terms “Company,” “we,” “our,” “ours” and “us” refer to Tempur-Pedic International Inc. and its consolidated subsidiaries.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per common share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net sales	\$ 342,212	\$ 263,044	\$ 668,050	\$ 516,933
Cost of sales	161,194	135,003	316,722	264,083
Gross profit	181,018	128,041	351,328	252,850
Selling and marketing expenses	67,980	46,827	132,350	93,058
General, administrative and other expenses	30,208	27,364	60,868	53,652
Operating income	82,830	53,850	158,110	106,140
Other expense, net:				
Interest expense, net	(2,646)	(3,786)	(5,185)	(6,975)
Other expense, net	(118)	(73)	(721)	(5)
Total other expense	(2,764)	(3,859)	(5,906)	(6,980)
Income before income taxes	80,066	49,991	152,204	99,160
Income tax provision	26,982	16,485	50,860	32,506
Net income	\$ 53,084	\$ 33,506	\$ 101,344	\$ 66,654
Earnings per common share:				
Basic	\$ 0.78	\$ 0.47	\$ 1.48	\$ 0.93
Diluted	\$ 0.76	\$ 0.46	\$ 1.44	\$ 0.90
Weighted average common shares outstanding:				
Basic	67,959	70,730	68,257	72,014
Diluted	70,018	73,152	70,469	74,438

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	June 30, 2011 (Unaudited)	December 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 86,739	\$ 53,623
Accounts receivable, net	140,413	115,630
Inventories	86,279	69,856
Prepaid expenses and other current assets	24,333	18,646
Deferred income taxes	12,199	13,725
Total Current Assets	349,963	271,480
Property, plant and equipment, net	162,081	159,807
Goodwill	213,602	212,468
Other intangible assets, net	66,940	68,745
Other non-current assets	9,439	3,503
Total Assets	\$ 802,025	\$ 716,003
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 63,246	\$ 48,288
Accrued expenses and other current liabilities	85,803	85,469
Income taxes payable	18,714	12,477
Total Current Liabilities	167,763	146,234
Long-term debt	475,000	407,000
Deferred income taxes	30,787	32,315
Other non-current liabilities	4,512	4,421
Total Liabilities	678,062	589,970
Commitments and contingencies—see Note 9		
Total Stockholders' Equity	123,963	126,033
Total Liabilities and Stockholders' Equity	\$ 802,025	\$ 716,003

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 101,344	\$ 66,654
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,590	15,706
Amortization of stock-based compensation	7,719	5,339
Amortization of deferred financing costs	346	345
Bad debt expense	1,137	1,278
Deferred income taxes	(1,133)	1,275
Foreign currency adjustments and other	826	(2,150)
Changes in operating assets and liabilities	(22,879)	(20,625)
Net cash provided by operating activities	103,950	67,822
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of business, net of cash acquired	—	(18,692)
Acquisition of trademarks and other	(1,970)	(184)
Purchases of property, plant and equipment	(12,098)	(6,698)
Net cash used by investing activities	(14,068)	(25,574)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term revolving credit facility	572,500	222,336
Repayments of long-term revolving credit facility	(504,500)	(83,313)
Payments of deferred finance costs	(6,109)	—
Proceeds from issuance of common stock	22,386	19,470
Excess tax benefit from stock based compensation	14,133	2,613
Treasury shares repurchased	(160,010)	(200,000)
Net cash used by financing activities	(61,600)	(38,894)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		
	4,834	(2,029)
Increase in cash and cash equivalents	33,116	1,325
CASH AND CASH EQUIVALENTS, beginning of period	53,623	14,042
CASH AND CASH EQUIVALENTS, end of period	\$ 86,739	\$ 15,367
Supplemental cash flow information:		
Cash paid during the period for:		
Interest	\$ 4,973	\$ 6,397
Income taxes, net of refunds	\$ 32,721	\$ 23,641

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per common share amounts)

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation and Description of Business. Tempur-Pedic International Inc., a Delaware corporation, together with its subsidiaries is a U.S. based, multinational company. The term “Tempur-Pedic International” refers to Tempur-Pedic International Inc. only, and the term “Company” refers to Tempur-Pedic International Inc. and its consolidated subsidiaries.

The Company manufactures, markets and sells products including pillows, mattresses and other related products. The Company manufactures essentially all its pressure-relieving TEMPUR® products at three manufacturing facilities, with one located in Denmark and two in the U.S. The Company has sales distribution subsidiaries operating in North America, Europe and Asia Pacific and has third party distribution arrangements in certain other countries where it does not have subsidiaries. The Company sells its products through four sales channels: Retail, Direct, Healthcare and Third party.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States (U.S. GAAP) for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the consolidated financial statements of the Company and related footnotes for the year ended December 31, 2010, included in the Company’s Annual Report on Form 10-K.

The results of operations for the interim periods are not necessarily indicative of results of operations for a full year. It is the opinion of management that all necessary adjustments for a fair presentation of the results of operations for the interim periods have been made and are of a recurring nature unless otherwise disclosed herein.

(b) Reclassifications. Certain prior period amounts have been reclassified to conform to the 2011 presentation of Condensed Consolidated Financial Statements, including a reclassification between current Deferred income tax assets and Prepaid expenses and other current assets. Additionally, during the fourth quarter of 2010, the Company purchased its noncontrolling interest in Tempur Shanghai Holding Ltd. Income attributable to the noncontrolling interest was not material in 2010 and is presented within Other expense, net in the Condensed Consolidated Statements of Income. These changes do not materially impact previously reported subtotals within the Condensed Consolidated Financial Statements for any previous period presented.

(c) Basis of Consolidation. The accompanying Condensed Consolidated Financial Statements include the accounts of Tempur-Pedic International and its subsidiaries. All subsidiaries are wholly-owned. During the fourth quarter of 2010, the Company purchased its noncontrolling interest in Tempur Shanghai Holding Ltd. Intercompany balances and transactions have been eliminated.

(d) Use of Estimates. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company’s results are affected by economic, political, legislative, regulatory and legal actions. Economic conditions, such as recessionary trends, inflation, interest and monetary exchange rates, government fiscal policies and changes in the prices of raw

materials, can have a significant effect on operations. While the Company maintains reserves for anticipated liabilities and carries various levels of insurance, the Company could be affected by civil, criminal, regulatory or administrative actions, claims or proceedings.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

(e) Inventories. Inventories are stated at the lower of cost or market, determined by the first-in, first-out method, and consist of the following:

	June 30, 2011	December 31, 2010
Finished goods	\$ 66,674	\$ 53,362
Work-in-process	7,325	5,549
Raw materials and supplies	12,280	10,945
	\$ 86,279	\$ 69,856

(f) Accrued Sales Returns. The Company allows product returns up to 120 days following a sale through certain sales channels and on certain products. Estimated sales returns are provided at the time of sale based on historical sales channel return rates. The level of sales returns differs by channel with the Direct channel typically experiencing the highest rate of return. Estimated future obligations related to these products are provided by a reduction of sales in the period in which the revenue is recognized. Accrued sales returns are included in Accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

The Company had the following activity for sales returns from December 31, 2010 to June 30, 2011:

Balance as of December 31, 2010	\$4,402
Amounts accrued	25,637
Returns charged to accrual	(24,000)
Balance as of June 30, 2011	\$6,039

(g) Warranties. The Company provides a 20-year warranty for North American sales and a 15-year warranty for International sales on mattresses, each prorated for the last 10 years. The Company also provides a 2-year to 3-year warranty on pillows. Estimated future obligations related to these products are charged to operations in the period in which the related revenue is recognized. Estimates of warranty expenses are based primarily on historical claim experience and product testing. Warranties are included in Accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

The Company had the following activity for warranties from December 31, 2010 to June 30, 2011:

Balance as of December 31, 2010	\$4,081
Amounts accrued	3,212
Warranties charged to accrual	(2,800)
Balance as of June 30, 2011	\$4,493

(h) Revenue Recognition. Sales of products are recognized when persuasive evidence of an arrangement exists, products are shipped and title passes to customers and the risks and rewards of ownership are transferred, the sales price is fixed or determinable and collectability is reasonably assured. The Company extends volume discounts to certain customers and reflects these amounts as a reduction of sales. The Company also reports sales net of tax assessed by qualifying governmental authorities. The Company extends credit based on the creditworthiness of its customers. No collateral is required on sales made in the normal course of business.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company regularly reviews the adequacy of its allowance for doubtful accounts. The Company determines the allowance based on historical write-off experience and current economic conditions. It also considers factors such as customer credit, past transaction history with the customer and changes in customer payment terms when determining whether the collection of a receivable is reasonably assured. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts included in Accounts receivable, net in the accompanying Condensed Consolidated Balance Sheets was \$8,483 and \$7,437 as of June 30, 2011 and December 31, 2010, respectively.

(i) Advertising Costs. The Company expenses advertising costs as incurred except for production costs and advance payments, which are deferred and expensed when advertisements run for the first time. Direct response advance payments are deferred and are amortized over the life of the program.

(j) Research and Development Expenses. Research and development expenses for new products are expensed as they are incurred and included in General, administrative and other expenses in the accompanying Condensed Consolidated Statements of Income. Research and development costs charged to expense were approximately \$2,566 and \$1,699 for the three months ended June 30, 2011 and 2010, respectively. For the six months ended June 30, 2011 and 2010, research and development costs charged to expense were \$4,900 and \$3,549, respectively.

(k) Subsequent Events. On July 4, 2011, the Company acquired its third party distributor in South Korea. Approximately \$4,500 in cash was paid in order to acquire this entity. Additional payments are required to the former owners based on certain financial and operational targets.

On July 25, 2011, the Company's Board of Directors terminated the remaining authority under the January 2011 authorization and approved a new share repurchase authorization of up to \$200,000 of the Company's common stock. Share repurchases under this authorization may be made through open market transactions, negotiated purchases or otherwise, at times and in such amounts as management and a committee of the Board deem appropriate; these repurchases may be funded by operating cash flows and/or borrowings under our credit facility. This share repurchase program may be limited, suspended or terminated at any time without notice.

(2) Goodwill and Other intangible assets

The following summarizes changes to the Company's Goodwill, by reportable business segment:

	North America	International	Total
Balance as of December 31, 2010	\$ 108,931	\$ 103,537	\$ 212,468
Foreign currency translation adjustments	594	540	1,134
Balance as of June 30, 2011	\$ 109,525	\$ 104,077	\$ 213,602

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The following table summarizes information relating to the Company's Other intangible assets, net:

		June 30, 2011		December 31, 2010			
	Useful Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Unamortized indefinite life intangible assets:							
Trademarks		\$ 55,000	\$ —	\$ 55,000	\$ 55,000	\$ —	\$ 55,000
Amortized intangible assets:							
Technology	10	\$ 16,000	\$ 13,867	\$ 2,133	\$ 16,000	\$ 13,067	\$ 2,933
Patents & other trademarks	5-20	12,609	8,896	3,713	12,063	8,575	3,488
Customer database	5	4,864	4,798	66	4,813	4,691	122
Foam formula	10	3,700	3,207	493	3,700	3,022	678
Reacquired rights	3	5,948	2,478	3,470	5,767	1,440	4,327
Customer relationships	5	2,599	534	2,065	2,492	295	2,197
Total		\$ 100,720	\$ 33,780	\$ 66,940	\$ 99,835	\$ 31,090	\$ 68,745

Amortization expense relating to intangible assets for the Company was \$1,283 and \$1,233 for the three months ended June 30, 2011 and 2010, respectively. For the six months ended June 30, 2011 and 2010, amortization expense relating to intangible assets was \$2,549 and \$1,904, respectively. No impairments of goodwill or other intangible assets have adjusted the gross carrying amount of these assets in any historical period.

3) Long-term Debt

(a) Long-term Debt. Long-term debt for the Company consists of the following:

	June 30, 2011	December 31, 2010
Senior Credit Facility:		
Domestic Long-Term Revolving Credit Facility payable to lenders, interest at Base Rate or LIBOR plus applicable margin (1.94% and 1.87% as of June 30, 2011 and December 31, 2010, respectively), commitment through and due June 28, 2016	\$ 475,000	\$ 407,000
Long Term Debt	\$ 475,000	\$ 407,000

(b) Secured Credit Financing. On October 18, 2005, the Company entered into a credit agreement (Senior Credit Facility) with a syndicate of banks. On June 28, 2011, the Company amended and restated its Senior Credit Facility, as amended, which increased the total availability under the Senior Credit Facility to an aggregate of \$770,000, added an option to increase domestic availability by an additional \$250,000, extended the maturity date to June 28, 2016,

and increased the applicable margins and certain fees to current market conditions.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The Senior Credit Facility consists of domestic and foreign credit facilities (Revolvers) that provide for the incurrence of indebtedness up to an aggregate principal amount of \$770,000 and matures in 2016. The domestic credit facility is a five-year, \$745,000 revolving credit facility (Domestic Revolver). The foreign credit facility is a five-year, \$25,000 revolving credit facility (Foreign Revolver). The Revolvers provide for the issuance of letters of credit and bank guarantees (Contingent Liabilities) which, when issued, constitute usage and reduce availability under the Revolvers. The aggregate amount of Contingent Liabilities outstanding under the Revolvers was \$990 at June 30, 2011. After giving effect to Contingent Liabilities and \$475,000 in borrowings under the Revolvers, total availability under the Revolvers was \$294,010 as of June 30, 2011. Both credit facilities bear interest at a rate equal to the applicable margin, as determined in accordance with a performance pricing grid set forth in the Senior Credit Facility, plus one of the following indexes: London Inter-Bank Offering Rate (LIBOR) and for U.S. dollar-denominated loans only, a base rate. The base rate of U.S. dollar-denominated loans is defined as the higher of the Bank of America prime rate or the Federal Funds rate plus .50%. The Company also pays an annual commitment fee on the unused amount of the Senior Credit Facility. The commitment fee is calculated based on the consolidated leverage ratio and ranges from .375% to .50%.

The Senior Credit Facility is guaranteed by Tempur-Pedic International, as well as certain other subsidiaries of Tempur-Pedic International, and is secured by certain fixed and intangible assets of Dan-Foam ApS and substantially all the Company's U.S. assets. The Senior Credit Facility contains certain financial covenants and requirements affecting the Company, including a consolidated interest coverage ratio and a consolidated leverage ratio. The Company was in compliance with all covenants as of June 30, 2011.

In conjunction with the Company amending and restating its Senior Credit Facility, approximately \$6,109 of deferred financing costs were capitalized and will be amortized over the five year extension.

In May 2008, the Company entered into a three year interest rate swap agreement to manage interest costs and the risk associated with changing interest rates associated with the Senior Credit Facility. Refer to Note 5, "Derivative Financial Instruments" for additional information regarding the Company's derivative instruments, including this interest rate swap. The interest rate swap expired on May 31, 2011.

(4) Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset and liability in an orderly transaction between market participants at the measurement date. The Company estimates fair value of its financial instruments utilizing an established three-level hierarchy. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date as follows:

- Level 1 – Valuation is based upon unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 – Valuation is based upon quoted prices for similar assets and liabilities in active markets, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 – Valuation is based upon other unobservable inputs that are significant to the fair value measurements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement. There were no transfers between levels for the three months ended June 30, 2011. At June 30, 2011, the Company had foreign currency forward contracts recorded at fair value. The fair values of these instruments were measured using valuations based upon quoted prices for similar assets and liabilities in active markets (Level 2) and are valued by reference to similar financial instruments, adjusted for credit risk and restrictions and other terms specific to the contracts. The following table provides a summary by level of the fair value of financial instruments that are measured on a recurring basis:

Fair Value Measurements at June 30, 2011 Using:				
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	June 30, 2011			
Liabilities:				
Foreign currency forward contracts	\$ 52	\$ —	\$ 52	\$ —

Fair Value Measurements at December 31, 2010 Using:				
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	December 31, 2010			
Liabilities:				
Foreign currency forward contracts	\$ 676	\$ —	\$ 676	\$ —
Interest rate swap	\$ 1,430	\$ —	\$ 1,430	\$ —

The carrying value of Cash and cash equivalents, Accounts receivable and Accounts payable approximate fair value because of the short-term maturity of those instruments. Borrowings under the Senior Credit Facility (as defined in Note 3(b)) are at variable interest rates and accordingly their carrying amounts approximate fair value.

(5) Derivative Financial Instruments

In the normal course of business, the Company is exposed to certain risks related to fluctuations in interest rates and foreign currency exchange rates. The Company uses various derivative contracts, primarily interest rate swaps and foreign currency exchange forward contracts, to manage risks from these market fluctuations. The financial instruments used by the Company are straight-forward, non-leveraged instruments. The counterparties to these financial instruments are financial institutions with strong credit ratings. The Company maintains control over the size of positions entered into with any one counterparty and regularly monitors the credit ratings of these institutions.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The Company is exposed to foreign currency risk related to intercompany debt and associated interest payments. To manage the risk associated with fluctuations in foreign currencies, the Company enters into foreign currency forward contracts. The Company does not designate any of these foreign currency forward contracts as hedging instruments, however, the Company considers the contracts as economic hedges. Accordingly, changes in the fair value of these instruments affect earnings during the current period. These foreign currency forward contracts protect against the reduction in value of forecasted foreign currency cash flows resulting from payments in foreign currencies. The fair value of foreign currency agreements are estimated as described in Note 4, "Fair Value Measurements", taking into consideration foreign currency rates and the current creditworthiness of the counterparties or the Company, as applicable.

As of June 30, 2011, the Company had foreign currency forward contracts with expiration dates ranging from July 7, 2011 through October 28, 2011. The changes in fair value of these foreign currency hedges are included as a component of Other expense, net. As of June 30, 2011, the Company had the following outstanding foreign currency forward contracts:

Foreign Currency Denomination	Notional Amount
Japanese Yen	¥ 493,695
Swedish Krona	kr. 8,755
Norwegian Krone	kr. 8,389
Australian Dollar	\$ 2,834
New Zealand Dollar	\$ 1,518
Singapore Dollar	\$ 1,011
Canadian Dollar	\$ 826
United States Dollar	\$ 14,927

As of June 30, 2011 and December 31, 2010, the fair value carrying amount of the Company's derivative instruments were recorded as follows:

	Liability Derivatives			
	June 30, 2011		December 31, 2010	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
	Accrued expenses and other current liabilities	\$ —	Accrued expenses and other current liabilities	\$ 1,430
Derivatives not designated as hedging instruments				
Foreign exchange forward contracts	Accrued expenses and other current	\$ 52	Accrued expenses and other current	\$ 676

liabilities	liabilities
\$ 52	\$ 2,106

The effect of derivative instruments on the accompanying Condensed Consolidated Statements of Income for the three months ended June 30, 2011 was as follows:

	Amount of Gain/(Loss) Recognized in Accumulated OCI on Derivative (Effective Portion)	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives Designated as Cash Flow Hedging Relationships					
Interest rate swap	\$ 582	Interest expense, net	\$ (582)	Interest expense, net	\$ —

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments		
Foreign exchange forward contracts	Other expense, net	\$ (211)

For the three months ended June 30, 2010:

	Amount of Gain/(Loss) Recognized in Accumulated OCL on Derivative (Effective Portion)	Location of Gain/(Loss) Reclassified from Accumulated OCL into Income (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCL into Income (Effective Portion)	Location of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives Designated as Cash Flow Hedging Relationships					
Interest rate swap	\$ 1,788	Interest expense, net	\$ (1,757)	Interest expense, net	\$ —

	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments		
Foreign exchange forward contracts	Other expense, net	\$ (387)

The effect of derivative instruments on the accompanying Condensed Consolidated Statements of Income for the six months ended June 30, 2011 was as follows:

Derivatives Designated as Cash Flow Hedging Relationships	Amount of Gain/(Loss) Recognized in Accumulated OCL on Derivative (Effective Portion)	Location of Gain/(Loss) Reclassified from Accumulated OCL into Income (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCL into Income (Effective Portion)	Location of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Loss Recognized in Income on Derivative (Ineffective Portion and Amount Excluded
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				from Effectiveness Testing)	
Interest rate swap	\$	1,430	Interest expense, net	\$	(1,446)
				Interest expense, net	\$
				—	
				Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
Derivatives Not Designated as Hedging Instruments					
Foreign exchange forward contracts			Other expense, net	\$	1,038

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

For the six months ended June 30, 2010:

	Amount of Gain/(Loss) Recognized in Accumulated OCL on Derivative (Effective Portion)	Location of Gain/(Loss) Reclassified from Accumulated OCL into Income (Effective Portion)	Amount of Gain/(Loss) Reclassified from Accumulated OCL into Income (Effective Portion)	Location of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain/(Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives Designated as Cash Flow Hedging Relationships	\$ 2,723	Interest expense, net	\$ (3,488)	Interest expense, net	\$ —
Derivatives Not Designated as Hedging Instruments				Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
Foreign exchange forward contracts				Other expense, net	(1,353)

(6) Stockholders' Equity

(a) Capital Stock. Tempur-Pedic International's authorized shares of capital stock are 300,000 shares of common stock and 10,000 shares of preferred stock. Subject to preferences that may be applicable to any outstanding preferred stock, holders of the common stock are entitled to receive ratably such dividends as may be declared from time to time by the Board of Directors out of funds legally available for that purpose. In the event of liquidation, dissolution or winding up, the holders of the common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred stock, if any, then outstanding.

(b) Share Repurchase Programs. During the six months ended June 30, 2011, the Company purchased 2,914 shares of the Company's common stock for a total of \$160,010 pursuant to the authorization made by the Company's Board of Directors in January 2011. During the six months ended June 30, 2010, the Company purchased 6,686 shares of the Company's common stock for a total cost of \$200,000 pursuant to the authorizations made by the Company's Board of Directors in January and April of 2010. On July 25, 2011, the Company's Board of Directors terminated the remaining authority under the January 2011 authorization and approved a new share repurchase authorization of up to \$200,000 of the Company's common stock. Share repurchases under this authorization may be made through open market transactions, negotiated purchases or otherwise, at times and in such amounts as management and a committee of the Board deem appropriate; these repurchases may be funded by operating cash flows and/or borrowings under our credit facility. This share repurchase program may be limited, suspended or terminated at any time without notice.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

(7) Other Items

(a) Property, plant and equipment.

Property, plant and equipment, net consisted of the following:

	June 30, 2011	December 31, 2010
Land and buildings	\$ 126,331	\$ 121,188
Machinery and equipment, furniture and fixtures and other	221,150	208,310
Construction in progress	12,449	9,858
	359,930	339,356
Accumulated depreciation	(197,849)	(179,549)
	\$ 162,081	\$ 159,807

(b) Accrued expenses and other current liabilities.

Accrued expenses and other current liabilities consisted of the following:

	June 30, 2011	December 31, 2010
Salary and related expenses	\$ 18,509	\$ 22,171
Accrued unrecognized tax benefits	12,153	12,035
Advertising accrual	12,215	6,981
Accrued sales and value added taxes	8,614	10,614
Sales returns	4,493	4,081
Warranty accrual	6,039	4,402
Other	23,780	25,185
	\$ 85,803	\$ 85,469

(c) Accumulated other comprehensive income (loss).

Accumulated other comprehensive income (loss) consisted of the following:

	June 30, 2011	December 31, 2010
Derivative instruments accounted for as hedges, net of taxes of \$0 and \$558	\$ —	\$ (872)
Foreign currency translation adjustments	6,170	(5,316)
Accumulated other comprehensive income (loss)	\$ 6,170	\$ (6,188)

(d) Comprehensive income.

The components of comprehensive income consisted of the following:

Three Months Ended

Six Months Ended

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	June 30,		June 30,	
	2011	2010	2011	2010
Net income	\$ 53,084	\$ 33,506	\$ 101,344	\$ 66,654
Derivative instruments accounted for as hedges, net of taxes of \$227, \$698, \$558 and \$1,063, respectively	355	1,091	872	1,661
Cumulative translation adjustment	3,996	(7,892)	11,486	(13,320)
Total comprehensive income	\$ 57,435	\$ 26,705	\$ 113,702	\$ 54,995

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

(8) Stock-Based Compensation

The Company currently has three stock-based compensation plans: the 2002 Option Plan (2002 Plan), the Amended and Restated 2003 Equity Incentive Plan (2003 Plan) and the 2003 Employee Stock Purchase Plan (ESPP), which are described under the caption “Stock-based Compensation” in the notes to the Consolidated Financial Statements of the Company’s Annual Report on Form 10-K for the year ended December 31, 2010. Effective February 1, 2010, the Company suspended offerings under the ESPP indefinitely.

In the first quarter of 2010, the Compensation Committee of the Board of Directors approved the terms of a Long-Term Incentive Program (LTIP), established under the 2003 Plan. The LTIP awards consist of a mix of stock options and performance-based restricted stock units (RSUs). Shares with respect to the RSUs will be granted, if they vest, following the end of the applicable performance period and achievement of applicable performance metrics as determined by the Compensation Committee of the Board of Directors.

The Company granted RSUs during the six months ended June 30, 2011. The maximum number of shares to be awarded under the RSUs granted during the six months ended June 30, 2011 will be 443 shares, and will vest, if earned, at the end of the three-year performance period ending on December 31, 2013. No RSUs were granted during the three months ended June 30, 2011. Actual payout under the RSUs granted in 2011 is dependent upon the achievement of certain financial goals, based on Net sales and Earnings Before Interest and Taxes (EBIT) margin targets. Based on current estimates of the performance metrics, unrecognized compensation expense with respect to the RSUs was \$6,084 as of June 30, 2011, which is expected to be recorded over the weighted average remaining life of 2.51 years. The maximum number of shares to be awarded under the RSUs granted during the three and six months ended June 30, 2010 will be 12 and 418, respectively. The Company recorded \$3,133 and \$356 of compensation expense associated with RSUs for the three months ended June 30, 2011 and June 30, 2010, respectively. The Company recorded \$4,011 and \$463 of compensation expense associated with RSUs for the six months ended June 30, 2011 and 2010, respectively.

The Company granted options to purchase 7 and 83 shares of common stock during the three and six months ending June 30, 2011. The Company granted options to purchase 33 and 162 shares of common stock during the three and six months ending June 30, 2010, respectively. The Company recorded \$1,335 and \$2,050 of compensation expense associated with options for the three months ended June 30, 2011 and June 30, 2010, respectively. The Company recorded \$2,694 and \$4,172 of compensation expense associated with options for the six months ended June 30, 2011 and 2010, respectively. As of June 30, 2011, there was \$1,733 of unrecognized compensation expense associated with the options granted in 2011, which is expected to be recorded over the weighted average remaining vesting period of 2.50 years. The options granted in the three months ended June 30, 2011 had a weighted average grant-date fair value of \$24.99 per option, as determined by the Black-Scholes option pricing model using the following assumptions:

Expected volatility of stock	72.25	%
Expected life of options, in years	3.0	
Risk-free interest rate	1.09	%
Expected dividend yield on stock	0.0	%

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The Company granted deferred stock unit (DSU) awards during the three and six months ended June 30, 2011. As of June 30, 2011, there was \$488 of unrecognized compensation expense associated with the DSUs granted in 2011, which is expected to be recorded over the weighted average remaining vesting period of 0.82 years. The Company granted 12 and 188 awards during the three and six months ended June 30, 2010 that consisted of restricted stock units (RSUs) and DSUs. The Company recorded \$522 of compensation expense associated with RSUs and DSUs for the three months ended June 30, 2011 and June 30, 2010. The Company recorded \$1,014 and \$689 of compensation expense associated with RSUs and DSUs for the six months ended June 30, 2011 and 2010, respectively.

The Company recorded \$4,990 and \$2,928 of total stock-based compensation expense for the three months ended June 30, 2011 and June 30, 2010, respectively. The Company recorded \$7,719 and \$5,339 of total stock-based compensation expense for the six months ended June 30, 2011 and 2010, respectively.

(9) Commitments and Contingencies

(a) Purchase Commitments. The Company will, from time to time, enter into limited purchase commitments for the purchase of certain raw materials. Amounts committed under these programs were not significant as of June 30, 2011 or December 31, 2010.

(b) Antitrust Action. On January 5, 2007, a purported class action was filed against the Company in the United States District Court for the Northern District of Georgia, Rome Division (Jacobs v. Tempur-Pedic International, Inc. and Tempur-Pedic North America, Inc., or the Antitrust Action). The Antitrust Action alleges violations of federal antitrust law arising from the pricing of Tempur-Pedic mattress products by Tempur-Pedic North America and certain distributors. The action alleges a class of all purchasers of Tempur-Pedic mattresses in the United States since January 5, 2003, and seeks damages and injunctive relief. Count Two of the complaint was dismissed by the court on June 25, 2007, based on a motion filed by the Company. Following a decision issued by the United States Supreme Court in Leegin Creative Leather Prods., Inc. v. PSKS, Inc. on June 28, 2007, the Company filed a motion to dismiss the remaining two counts of the Antitrust Action on July 10, 2007. On December 11, 2007, that motion was granted and, as a result, judgment was entered in favor of the Company and the plaintiffs' complaint was dismissed with prejudice. On December 21, 2007, the plaintiffs filed a "Motion to Alter or Amend Judgment," which was fully briefed. On May 1, 2008, that motion was denied. Jacobs appealed the dismissal of their claims, and the parties argued the appeal before the United States Circuit Court for the Eleventh Circuit on December 11, 2008. The Court rendered an opinion favorable to the Company on December 2, 2010, affirming the trial court's refusal to allow Jacobs to alter or amend its pleadings and dismissing its claims. Jacobs has subsequently petitioned the 11th Circuit Court of Appeals for an "en banc" review of the three judge panel's ruling. The Company continues to strongly believe that the Antitrust Action lacks merit, and intends to defend against the claims vigorously. Based on the findings of the court to date and an assessment of the Company's meritorious defenses, the Company believes that it is remote that it will incur a loss with respect to this matter. However, due to the inherent uncertainties of litigation, the Company cannot predict the outcome of the Antitrust Action at this time, and can give no assurance that these claims will not have a material adverse affect on the Company's financial position or results of operation.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

(c) New York Attorney General. In December 2008, the Office of the Attorney General of the State of New York, Antitrust Bureau (OAG) requested that the Company consider discontinuing its unilateral retail price policy (UPPL) in the State of New York, and informed the Company that it may bring an enforcement action against the Company under New York law if the Company chose not to do so. On March 29, 2010, the Office of the Attorney General filed suit in New York state court against the Company with respect to this matter. The complaint does not charge the Company with any violation of state or federal antitrust law; instead it claims the Company violated a 1975 New York state law which declares certain contractual provisions to be unenforceable and not actionable at law and seeks, among other things, a permanent injunction prohibiting the Company's UPPL as well as unspecified sums for restitution and disgorgement of profits. The Company responded to the complaint and also filed motions to dismiss and to obtain discovery. On September 28, 2010, the court heard various motions filed by the parties and took them under advisement. On January 14, 2011, the court denied the OAG's petition in full and granted the Company's motion to dismiss. The OAG filed an appeal on February 22, 2011. The Company believes that its UPPL complies with state and federal law and intends to continue to vigorously defend it in this matter. No claim for damages has been received by the Company. Based on the findings of the court to date and an assessment of the Company's meritorious defenses, the Company believes that it is remote that it will incur a loss with respect to this matter. However, due to the inherent uncertainties of litigation, the Company cannot predict the outcome of this matter at this time, and can give no assurance that these claims will not have a material adverse affect on the Company's financial position or results of operations.

The Company is involved in various other legal proceedings incidental to the operations of its business. The Company believes that the outcome of all such pending legal proceedings in the aggregate will not have a material adverse affect on its business, financial condition, liquidity, or operating results.

(10) Income Taxes

The Company's effective tax rate for the three months ended June 30, 2011 and June 30, 2010 was 33.7% and 33.0%, respectively. The Company's effective tax rate for the six months ended June 30, 2011 and June 30, 2010 was 33.4% and 32.7%, respectively. The Company's effective income tax rate for the three and six months ended June 30, 2011 and 2010 differed from the federal statutory rate of 35.0% principally because of certain foreign tax rate differentials, state and local income taxes, foreign income currently taxable in the U.S., the production activities deduction and certain other permanent differences.

The Company has not provided for U.S. federal and/or state income and foreign withholding taxes on \$285,871 of undistributed earnings from non-U.S. operations as of June 30, 2011 because Tempur-Pedic International intends to reinvest such earnings indefinitely outside of the United States. If these earnings were to be distributed, foreign tax credits may become available under current law to reduce the resulting U.S. income tax liability.

During the fourth quarter of 2007, the Company received an income tax assessment from the Danish Tax Authority with respect to the 2001, 2002 and 2003 tax years, an assessment with respect to the 2004 tax year during the third quarter of 2010, and an assessment with respect to the 2005 tax year during the second quarter of 2011. The tax assessments relate to the royalty paid by one of Tempur-Pedic International's U.S. subsidiaries to a Danish subsidiary and the position taken by the Danish Tax Authority could apply to subsequent years. The total tax assessment is approximately \$103,050 including interest and penalties. In the first quarter of 2008 and the third quarter of 2010, the Company filed timely complaints with the Danish National Tax Tribunal denying the tax

assessments. The National Tax Tribunal formally agreed to place the Danish tax litigation on hold pending the outcome of a Bilateral Advance Pricing Agreement (Bilateral APA) between the United States and the Danish Tax Authority. A Bilateral APA involves an agreement between the Internal Revenue Service (IRS) and the taxpayer, as well as a negotiated agreement with one or more foreign competent authorities under applicable income tax treaties. During the third quarter of 2008, the Company filed the Bilateral APA with the IRS and the Danish Tax Authority. U.S. and Danish competent authorities initially met to discuss the Company's Bilateral APA during the first quarter of 2011 and additional meetings are expected. The Company believes it has meritorious defenses to the proposed adjustments and will oppose the assessments in the Danish courts, as necessary. It is reasonably possible the amount of unrecognized tax benefits may change in the next twelve months. An estimate of the amount of such change cannot be made at this time.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to tax examinations by tax authorities in the U.S. for periods prior to 2007, U.S. state and local municipalities for periods prior to 2006, and in non-U.S. jurisdictions for periods prior to 2003. Additionally, the Company is currently under examination by various tax authorities around the world. The Company anticipates it is reasonably possible an increase or decrease in the amount of unrecognized tax benefits could be made in the next twelve months as a result of the statute of limitations expiring and/or the examinations being concluded on these returns. However, the Company does not presently anticipate that any increase or decrease in unrecognized tax benefits will be material to the consolidated financial statements. During the three and six months ended June 30, 2011, there were no significant changes to the liability for unrecognized tax benefits.

(11) Earnings Per Common Share

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Numerator:				
Net income	\$53,084	\$33,506	\$101,344	\$66,654
Denominator:				
Denominator for basic earnings per common share-weighted average shares	67,959	70,730	68,257	72,014
Effect of dilutive securities:				
Employee stock options	2,059	2,422	2,212	2,424
Denominator for diluted earnings per common share-adjusted weighted average shares	70,018	73,152	70,469	74,438
Basic earnings per common share	\$0.78	\$0.47	\$1.48	\$0.93
Diluted earnings per common share	\$0.76	\$0.46	\$1.44	\$0.90

The Company excluded 5 and 22 shares issuable upon exercise of outstanding stock options for the three months ended June 30, 2011 and 2010, respectively, and 60 and 96 share issuable upon exercise of outstanding stock options for the six month period ended June 30, 2011 and 2010, respectively, from the Diluted earnings per common share computation because their exercise price was greater than the average market price of Tempur-Pedic International's common stock or they were otherwise anti-dilutive.

(12) Business Segment Information

The Company operates in two business segments: North America and International. These reportable segments are strategic business units that are managed separately based on the fundamental differences in their operations. The North American segment consists of the two U.S. manufacturing facilities and our North American distribution subsidiaries. The International segment consists of the manufacturing facility in Denmark, whose customers include all of the distribution subsidiaries and third party distributors outside the North American segment. The Company

evaluates segment performance based on Net sales and Operating income.

The following table summarizes Total assets by segment:

	June 30, 2011	December 31, 2010
Total assets:		
North America	\$646,311	\$576,139
International	388,075	338,685
Intercompany eliminations	(232,361)	(198,821)
	\$802,025	\$716,003

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) – (Continued)
(In thousands, except per common share amounts)

The following table summarizes segment information:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net sales from external customers:				
North America				
Mattresses	\$ 175,270	\$ 136,686	\$ 334,715	\$ 254,072
Pillows	16,731	14,058	34,320	28,187
Other	55,111	41,478	107,080	76,516
	\$ 247,112	\$ 192,222	\$ 476,115	\$ 358,775
International				
Mattresses	\$ 57,348	\$ 41,932	\$ 115,239	\$ 93,617
Pillows	18,155	13,867	35,278	30,484
Other	19,597	15,023	41,418	34,057
	\$ 95,100	\$ 70,822	\$ 191,935	\$ 158,158
	\$ 342,212	\$ 263,044	\$ 668,050	\$ 516,933
Inter-segment sales:				
North America	38	—	314	—
International	\$ 503	\$ 456	\$ 1,227	\$ 661
Intercompany eliminations	(541)	(456)	(1,541)	(661)
	\$ —	\$ —	\$ —	\$ —
Gross Profit				
Domestic	\$ 124,211	\$ 87,957	\$ 236,016	\$ 161,917
International	56,807	40,084	115,312	90,933
	\$ 181,018	\$ 128,041	\$ 351,328	\$ 252,850
Operating income:				
North America	\$ 59,317	\$ 36,076	\$ 110,399	\$ 63,123
International	23,513	17,774	47,711	43,017
	\$ 82,830	\$ 53,850	\$ 158,110	\$ 106,140
Depreciation and amortization (including stock-based compensation amortization):				
North America	\$ 10,614	\$ 8,873	\$ 19,260	\$ 16,603
International	2,625	2,176	5,049	4,442
	\$ 13,239	\$ 11,049	\$ 24,309	\$ 21,045
Capital expenditures:				
North America	\$ 3,977	\$ 2,578	\$ 6,958	\$ 3,927
International	2,906	1,449	5,140	2,771
	\$ 6,883	\$ 4,027	\$ 12,098	\$ 6,698

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

The following discussion and analysis should be read in conjunction with the Condensed Consolidated Financial Statements and accompanying notes included in this Form 10-Q. Unless otherwise noted, all of the financial information in this report is condensed consolidated information for Tempur-Pedic International Inc. or its predecessor. The forward-looking statements in this discussion regarding the mattress and pillow industries, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements in this discussion include numerous risks and uncertainties, as described under "Special Note Regarding Forward-Looking Statements" and "Risk Factors" elsewhere in this quarterly report on Form 10-Q and in our annual report on Form 10-K for the year ended December 31, 2010. Our actual results may differ materially from those contained in any forward-looking statements. Except as may be required by law, we undertake no obligation to publicly update or revise any of the forward-looking statements contained herein.

In this discussion and analysis, we discuss and explain the financial condition and results of our operations for the three and six month periods ended June 30, 2011 and 2010, including the following points:

- An overview of our business and strategy;
- Our Net sales and costs in the periods presented as well as changes between periods;
- Discussion of new initiatives that may affect our future results of operations and financial condition;
- Expected future expenditures for capital projects and sources of liquidity for future operations; and
- The effect of the foregoing on our overall financial performance and condition, as well as factors that could affect our future performance.

Executive Overview

General. We are the leading manufacturer, marketer and distributor of premium mattresses and pillows which we sell in approximately 80 countries under the TEMPUR® and Tempur-Pedic® brands. We believe our premium mattresses and pillows are more comfortable than standard bedding products because our proprietary pressure-relieving TEMPUR® material is temperature sensitive, has a high density and therapeutically conforms to the body.

We sell our premium mattresses and pillows through four distribution channels: Retail (furniture and bedding, specialty and department stores); Direct (direct response, internet and company-owned stores); Healthcare (chiropractors, medical retailers, hospitals and other healthcare markets); and Third party distributors in countries where we do not sell directly through our own subsidiaries.

In our International segment certain of our subsidiaries sell directly through company-owned stores. Until recently these sales have been an immaterial amount and were reported through our Retail channel. In 2011, and consistent with our growth initiatives, we are reporting company-owned stores in the International segment within the Direct channel. Prior period amounts have been reclassified to conform to the 2011 presentation of Net sales, by channel and by segment. These changes do not impact previously reported International segment Net sales totals.

Business Segment Information. We have two reportable business segments: North America and International. These reportable segments are strategic business units that are managed separately based on the fundamental differences in their geographies. The North American operating segment consists of two U.S. manufacturing facilities, whose customers include our North American distribution subsidiaries. The International segment consists of our manufacturing facility in Denmark, whose customers include all of our distribution subsidiaries and third party distributors outside the North American segment. We evaluate segment performance based on Net sales and Operating income.

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On April 1, 2010, we purchased our Third party distributor in Canada. Accordingly, Net sales in the Canadian market are reported in the appropriate channels within the North American segment. As Canada represented essentially all sales through the North American Third party channel, we no longer report Third party sales in this segment.

Strategy and Outlook

Our goal is to become the world's favorite mattress and pillow brand. In order to achieve this long-term goal while managing through the current economic environment, we expect to continue to pursue certain key strategic goals using the related strategies discussed below.

- Make sure everyone knows that they would sleep better on a Tempur-Pedic - we plan to continue to invest in our global brand awareness through advertising campaigns that further associate our brand name with overall sleep and premium quality products.
- Make sure there is a Tempur-Pedic bed and pillow that appeals to everyone - we plan to continue to maintain our focus on premium mattresses and pillows and regularly introducing new products.
- Make sure that Tempur-Pedic is available to everyone - we plan to expand our points of distribution and the effectiveness of our distribution channels.
- Make sure that Tempur-Pedic continues to deliver the best sleep - we plan to continue to invest in product research and development.

In pursuing these strategic goals, we expect to continue to optimize our cost structure in order to enable these marketing and product development investments.

Results of Operations

Key financial highlights for the three and six months ended June 30, 2011 include the following:

- Earnings per diluted common share (EPS) were \$0.76 for the three months ended June 30, 2011 compared to \$0.46 for the three months ended June 30, 2010. For the six months ended June 30, 2011 EPS were \$1.44 compared to \$0.90 for the same period in 2010.
- Net sales for the three months ended June 30, 2011 increased to \$342.2 million from \$263.0 million for the same period in 2010. Net sales for the six months ended June 30, 2011 increased to \$668.1 million from \$516.9 million for the same period in 2010.
- Our Gross profit margin in the second quarter of 2011 was 52.9% compared to 48.7% for the second quarter of 2010. For the six months ended June 30, 2011 our Gross profit margin was 52.6% compared to 48.9% for the same period in 2010.
- During the six months ended June 30, 2011 we generated \$104.0 million of operating cash flow compared to \$67.8 million for the six months ended June 30, 2010.

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(In thousands,
except per
common share
amounts)

common share amounts)	Three Months Ended June 30,				Six Months Ended June 30,				
	2011		2010		2011		2010		
Net sales	\$	342,212	100.0%	\$	263,044	100.0%	\$	668,050	100.0%
Cost of sales		161,194	47.1		135,003	51.3		316,722	47.4
Gross profit		181,018	52.9					264,083	51.1