

TEMPUR PEDIC INTERNATIONAL INC  
Form 10-K  
January 30, 2012

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2011  
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 of registrant's principal executive offices) (Zip Code)  
Registrant's telephone number, including area code: (800) 878-8889  
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class  
Common Stock, \$0.01 par value

Name of Each Exchange on Which Registered  
New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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.

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

Large Accelerated filer  Accelerated filer  Non-Accelerated filer  Smaller Reporting Company

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

The aggregate market value of the common equity held by nonaffiliates of the registrant on June 30, 2011, computed by reference to the closing price for such stock on the New York Stock Exchange on such date, was approximately \$4,475,979,680.

The number of shares outstanding of the registrant's common stock as of January 27, 2012 was 63,803,592 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for the 2012 Annual Meeting of Stockholders, which is to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Form 10-K.

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Special Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K, 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; strategic long-term investments; 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; 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 Senior 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 7 of Part II 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 1 of this report. 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 I

ITEM 1. BUSINESS

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 have two reportable operating 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 and 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 operating segment. We evaluate segment performance based on Net sales and Operating income. For the results of our business segments, see ITEM 15. Exhibits and Financial Statement Schedules, Note 15, “Business Segment Information”, under Part IV of this report.

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

Our principal executive office is located at 1713 Jaggie Fox Way, Lexington, Kentucky 40511 and our telephone number is (800) 878-8889. Tempur Pedic International Inc. was incorporated under the laws of the State of Delaware in September 2002. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to such reports filed with or furnished to the Securities and Exchange Commission (SEC) pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), are available free of charge on our website at [www.tempurpedic.com](http://www.tempurpedic.com) as soon as reasonably practicable after such reports are electronically filed with the SEC.

You may read and copy any materials the Company files with the SEC at the SEC’s public reference room at 100 F Street NE, Washington, DC 20549. The public may obtain information about the operation of the public reference room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The website of the SEC is [www.sec.gov](http://www.sec.gov).

Market Opportunity and Competitive Strengths

Global Market

Most standard mattresses are made using innersprings and are primarily sold through retail furniture and bedding stores. Alternatives to innerspring mattresses include viscoelastic and foam mattresses, airbeds and waterbeds (collectively called non-innerspring mattresses).

The pillow market has a traditional and a specialty segment. Traditional pillows are generally made of low cost foam or feathers, other than down. Specialty pillows are comprised of all alternatives to traditional pillows, including viscoelastic, foam, sponge, rubber and down.

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### Our Market Position

We are the worldwide leader in premium sleep. We are focused on developing, manufacturing and marketing advanced sleep surfaces that help improve the quality of life for people around the world. We believe demand for our products is being driven by significant growth in our core demographic market, increased brand awareness and the broadening appeal of our new products. As consumers continue to prefer alternatives to standard innerspring mattresses, our products become more widely available and as our brand gains broader consumer recognition, we expect that our premium products will continue to attract sales from the standard mattress market.

### Superior Product Offerings

Our high-quality, high-density, temperature-sensitive TEMPUR® material distinguishes our products from other products in the marketplace. Viscoelastic pressure-relieving material was originally developed by the U.S. National Aeronautics and Space Administration (NASA) in 1971 in an effort to relieve astronauts of the G-force experienced during lift-off, and NASA subsequently made this formula publicly available. The NASA viscoelastic pressure-relieving material originally proved unstable for commercial use. However, after several years of research and development, we succeeded in developing a proprietary formulation and proprietary process to manufacture a stable, durable and commercially viable product. The key feature of our pressure-relieving TEMPUR® material is its temperature sensitivity. It conforms to the body, becoming softer in warmer areas where the body is making the most contact with the pressure-relieving TEMPUR® material and remaining firmer in cooler areas where less body contact is being made. As the material molds to the body's shape, the neck and spine are supported. Our pressure-relieving TEMPUR® material also has improved durability and enhanced comfort. In addition, clinical evidence indicates that our products are both effective and cost efficient for the prevention and treatment of pressure ulcers or bed sores, a major problem for elderly and bed-ridden patients.

### Increasing Global Brand Awareness

We believe consumers in the U.S. and internationally increasingly associate our brand name with premium quality products that enable better overall sleep. Our TEMPUR® brand has been in existence since 1991 and its global awareness is reinforced by our high level of customer satisfaction, as demonstrated by the recognition received by Consumer Reports, the Arthritis Foundation, the NASA Space Foundation, Good Housekeeping and Consumers Digest.

### Vertically Integrated Manufacturing and Supply Chain

We produce all of our proprietary TEMPUR® material in our own manufacturing facilities in the U.S. and Europe in order to precisely maintain the specifications of our products. We believe that our vertical integration, from the manufacture of the TEMPUR® material and fabrication and construction of our products through the marketing, sale and delivery of our products, ensures a high level of quality and performance that is not matched by our competition.

### Strong Financial Performance

Our business generates significant cash flow due to the combination of our sales, gross and operating margins, low maintenance capital expenditures and limited working capital requirements. For the year ended December 31, 2011, our Gross profit margin and Net income margin were 52.4% and 15.5%, respectively, on Net sales of \$1.4 billion. Our Net income margin allows our business model the flexibility to invest in our global brand, invest in research and development and new products, enhance our sales force, invest in our manufacturing operations, invest in information systems and recruit experienced management and other personnel.





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### Significant Growth Opportunities

We believe there are significant opportunities to take market share from the innerspring mattress industry as well as other sleep surfaces. Our market share of the overall mattress industry is relatively small in terms of both dollars and units, which we believe provides us with a significant opportunity for continued growth. By broadening our brand awareness and offering superior sleep surfaces, we believe consumers will over time adopt our products at an increasing rate, which should expand our market share. Additionally, by expanding distribution within our existing accounts, we believe we have the opportunity to grow our business. By extending our product line through our segmentation of products, we should be able to continue to expand the number of Tempur-Pedic models offered at the retail store level, which should lead to increased sales. Based on this strategy we believe a focus on expanding distribution within our existing accounts provides for continued growth opportunities and market shares gains. As of December 31, 2011 our products were sold in approximately 7,900 furniture and bedding retail stores in North America, out of a total of approximately 11,500 stores we have identified as appropriate targets. Within this addressable market, our plan is to increase our total penetration to a total of 9,000 to 10,000 over the long-term. Internationally, our products are available in approximately 5,200 furniture retail and department stores, out of a total of approximately 8,000 stores we have identified as appropriate targets. Accordingly, expanding our store distribution also provides for continued growth and market share opportunities. As consumers continue their shift toward the purchase of non-innerspring mattress products and sleep surfaces we believe we are well positioned to capitalize on this growth opportunity. However, our business may be affected by competition and general business and economic conditions that could have an impact on demand for our products, limit our market share and decrease sales.

### Our Products

#### Mattresses

Our mattresses represented 66.6% of our Net sales in 2011 and are our leading product category historically. Our mattresses are composed of proprietary multi-layer, temperature sensitive, pressure-relieving TEMPUR® material. We offer several mattress models, some of which are covered by one or more patents and/or patent applications. We also routinely introduce new mattress models, launch new products and update our existing mattress products in North America and internationally.

#### Pillows

Our premium pillow offerings include a variety of styles and represented 10.7% of Net sales in 2011. Our pillows provide plush and pressure-relieving comfort as the temperature sensitive material molds to the body.

#### Other Products

Our other products represented 22.7% of our Net sales in 2011. This category includes foundations used to support our mattress products, adjustable bed bases and many other types of offerings including a variety of cushions and other comfort products.

### Marketing and Sales

We primarily sell at wholesale through three distinct channels: Retail, Healthcare and Third party. We market directly to consumers in the U.S. and certain International markets through our Direct channel. Our marketing strategy is to increase consumer awareness of the benefits of our products and to further associate our brand name with better overall sleep and premium quality products. Throughout 2011, consistent with our strategy, we made additional investments in advertising to increase brand awareness to drive future growth in certain key North American and

International markets. In the U.S., we continue to invest in our “Ask Me”™ media campaign. Internationally, the “Weightless” media campaign was successfully launched in 2011. In 2012, we will expand our advertising to additional key markets in North America, and further expand our “Weightless” media campaign to additional International markets.

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In 2010, we also introduced a product segmentation strategy, which groups our products into collections with multiple models and price points, differentiated by functionality and specifications. In 2011, we introduced a new product segment in North America titled the TEMPUR®-Contour Collection, which replaced the TEMPUR® Collection, and launched the TEMPUR-Cloud® Collection in the International segment. Our North American product segments include TEMPUR®-Contour, TEMPUR®-HD and TEMPUR-Cloud® collections. We recently launched the TEMPUR-Simplicity™ collection in North America, which features mattress offerings for all product segments. Our International product segments include TEMPUR®, TEMPUR®-Sensation, and TEMPUR-Cloud® collections.

### Retail

The Retail channel sells to furniture and bedding retailers and department stores, among others. Our Retail channel represented 87.8% of Net sales in 2011. Our top five customers for the years ended December 31, 2011 and 2010 accounted for approximately 20.0% of our Net sales, and accounted for approximately 18.9% of our Net sales for the year ended December 31, 2009. The loss of one or more of these customers could negatively impact our profitability.

### Direct

The Direct channel sells directly to consumers through our call center operations and the internet in the U.S. and the United Kingdom, as well as our company-owned stores in certain international subsidiaries. Our direct response program targets customers in these markets through television, radio, home mailings, magazine, and newspaper product offering advertisements. Our Direct channel represented 7.1% of Net sales in 2011.

### Healthcare

The Healthcare channel sells to hospitals, nursing homes, healthcare professionals and medical retailers that utilize our products to treat patients, or may recommend or sell them to their clients. In addition, in the U.S. we are partnering with healthcare vendors in a sales method whereby the vendors integrate our TEMPUR® material into their products to improve patient comfort and wellness. These healthcare partners market our joint product offerings through established distribution channels. This channel represented 2.4% of Net sales in 2011.

### Third party

Third party sales represented 2.7% of Net sales in 2011. We utilize third party distributors to serve markets that are currently outside the range of our wholly-owned subsidiaries. Our approach to these developing markets has allowed us to build sales, marketing and brand awareness with minimal capital risk. We have entered into arrangements with third party distributors located in approximately 60 countries. As these markets mature we may seek to convert these third party relationships into wholly-owned subsidiaries.

### Seasonality

A significant portion of our Net sales is attributable to sales in our North American Retail channel, particularly sales to furniture and bedding stores. We believe that our sales of mattresses and pillows to furniture and bedding stores are typically subject to modest seasonality inherent in the bedding industry with sales expected to be generally lower in the second and fourth quarters and higher in the first and third quarters. Internationally, specifically in Europe, we are subject to seasonality with Net sales lower in the third quarter as compared to the other quarters during the year.

### Operations

### Manufacturing and Related Technology

Our mattresses and pillows are currently manufactured in our 517,000 square-foot facility located in Aarup, Denmark, our 540,000 square-foot facility in Duffield, Virginia and our 800,000 square-foot facility in Albuquerque, New Mexico. Most of the sewing and production of mattress and pillow covers is outsourced to third party suppliers.

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### Suppliers

We obtain the raw materials used to produce our pressure-relieving TEMPUR® material from outside sources. We currently acquire chemicals and proprietary additives from a number of suppliers with manufacturing locations around the world. We expect to continue these supplier relationships for the foreseeable future. We do not consider ourselves dependent upon any single outside vendor as a source of raw materials and believe that sufficient alternative sources of supply for the same or similar raw materials are available. Additionally, we source the manufacturing of our adjustable bed bases and foundations from third party manufacturers. We do not consider ourselves dependent upon any single outside manufacturer as a source of these products.

### Research and Development

Our research and development center located in Duffield, Virginia conducts technology and product development and product testing. Our Aarup, Denmark research and development center conducts technology and product development. Research and development expenses were \$9.9 million, \$7.4 million and \$6.5 million in 2011, 2010 and 2009, respectively.

### Competition

The mattress and pillow industries are highly competitive. Participants in the mattress and pillow industries have traditionally competed primarily based on price. Our premium mattresses compete with a number of different types of premium and standard mattress alternatives, including innerspring mattresses, foam mattresses, waterbeds, futons, air beds and other air-supported mattresses that are sold through a variety of channels, including furniture and bedding stores, department stores, mass merchants, wholesale clubs, telemarketing programs, television infomercials and catalogs. The pillow industry is characterized by a large number of competitors, none of which is dominant.

The standard mattress market in the U.S. is dominated by manufacturers of innerspring mattresses, with three nationally recognized brand names: Sealy, Serta and Simmons. These three competitors also offer premium innerspring mattresses and collectively have a significant share of the premium mattress market in the U.S. Select Comfort Corporation competes in the non-spring mattress market and focuses on the air mattress market segment. The balance of the mattress market in the U.S. is served by a large number of other manufacturers, primarily operating on a regional basis. Many of these competitors and, in particular, the three largest brands of innerspring mattresses named above, have significant financial, marketing and manufacturing resources, strong brand name recognition, and sell their products through broader and more established distribution channels. During the past several years, a number of our competitors, including Sealy, Serta and Simmons, have offered viscoelastic mattress and pillow products, including several new prominent product introductions in 2011.

The international market for mattresses and pillows is generally served by a large number of manufacturers, primarily operating on a regional basis. Some of these manufacturers also offer viscoelastic mattress and pillow products.

### Intellectual Property

We hold various U.S. and foreign patents and patent applications regarding certain elements of the design and function of many of our mattress and pillow products.

As of December 31, 2011, we held trademark registrations worldwide, which we believe have significant value and are important to the marketing of our products to retailers. TEMPUR® and Tempur-Pedic® are trademarks registered with the United States Patent and Trademark Office. In addition, we have U.S. applications pending for additional marks. Several of our trademarks have been registered, or are the subject of pending applications, in various foreign

countries. Each U.S. trademark registration is renewable indefinitely as long as the mark remains in use.

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## Governmental Regulation

Our operations are subject to state, local and foreign consumer protection and other regulations relating to the mattress and pillow industry. These regulations vary among the states and countries in which we do business. The regulations generally impose requirements as to the proper labeling of bedding merchandise, restrictions regarding the identification of merchandise as “new” or otherwise, controls as to hygiene and other aspects of product handling and sale and penalties for violations. The U.S. Consumer Product Safety Commission has adopted rules relating to fire retardancy standards for the mattress industry. Many foreign jurisdictions also regulate fire retardancy standards. Future changes to these standards may require modifications to our products to comply with these additional standards. We are also subject to environmental and health and safety requirements with regard to the manufacture of our products. We have made and will continue to make capital and other expenditures necessary to comply with all these requirements, currently these expenditures are immaterial to our financial results. We believe that we are in material compliance with the applicable federal, state, local and foreign rules and regulations governing our business.

## Employees

As of December 31, 2011, we had approximately 1,800 employees, with approximately 800 in North America, 300 in Denmark and 700 in the rest of the world. Certain of our employees in Denmark are covered by a government labor union contract as required by Danish law. None of our U.S. employees are covered by a collective bargaining agreement. We believe our relations with our employees are generally good.

## Executive Officers of the Registrant

Certain information concerning our executive officers as of the date of this report are set forth below. There are no family relationships between any of the persons listed below, or between any of such persons and any of our directors or any persons nominated or chosen by us to become a director or executive officer.

| Name                | Age | Position   |
|---------------------|-----|--|
| Mark Sarvary        | 52  | President and Chief Executive Officer                              |
| Dale E. Williams    | 49  | Executive Vice President and Chief Financial Officer               |
| Richard W. Anderson | 51  | Executive Vice President and President, North America              |
| Matthew D. Clift    | 52  | Executive Vice President of Global Operations                      |
| Lou H. Jones        | 61  | Executive Vice President, General Counsel and Secretary            |
| David Montgomery    | 51  | Executive Vice President and President of International Operations |
| Brad Patrick        | 47  | Executive Vice President and Chief Human Resources Officer         |
| Bhaskar Rao         | 46  | Chief Accounting Officer and Senior Vice President Finance         |



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Mark Sarvary joined Tempur-Pedic International in June 2008 and serves as President and Chief Executive Officer of Tempur-Pedic International. Prior to joining Tempur-Pedic, from January 2008 until June 2008, Mr. Sarvary served as an Operating Partner with CVC Capital Partners, a global private equity firm. Prior to CVC, from March 2004 to October 2007, Mr. Sarvary was the Executive Vice President and President of Campbell Soup Company, North America division, responsible for \$6 billion in business, including Campbell Soup, Pepperidge Farm, Pace, Prego and V8 as well as Godiva's global business. From 2002 until 2004, Mr. Sarvary was the President of Campbell's Pepperidge Farm division. Prior to joining Campbell's, from 1999 to 2002, Mr. Sarvary was the CEO of J. Crew Group, Inc., and from 1993 to 1999 he worked for Nestle, most recently as the President of the Stouffer's Frozen Food division. Earlier in his career, Mr. Sarvary worked as a strategy consultant with Bain & Company and in sales and marketing roles with IBM in Europe. Mr. Sarvary received his BSc in Physics from Kent University in the United Kingdom and an MBA from INSEAD Business School in France.

Dale E. Williams joined Tempur-Pedic International in July 2003 and serves as Executive Vice President and Chief Financial Officer. From November 2001 through 2002, Mr. Williams served as Vice President and Chief Financial Officer of Honeywell Control Products, a division of Honeywell International, Inc. From 2000 to 2001, Mr. Williams served as Vice President and Chief Financial Officer of Saga Systems, Inc./Software AG, Inc. Prior to that, Mr. Williams spent 15 years in various management positions at General Electric Company, most recently as Vice President and Chief Financial Officer of GE Information Services, Inc. Mr. Williams received his B.A. degree in finance from Indiana University.

Richard W. Anderson joined Tempur-Pedic International in July 2006 and serves as Executive Vice President and President, North America. From 1983 to 2006, Mr. Anderson was employed by The Gillette Company, which became a part of The Procter & Gamble Company in 2005. Mr. Anderson most recently served as the Vice President of Marketing for Oral-B and Braun in North America. Previously, Mr. Anderson was the Vice President of Global Business Management for Duracell. Mr. Anderson has held several management positions in marketing and sales as well as overseeing branding, product development and strategic planning. Mr. Anderson obtained B.S. and M.B.A. degrees from Virginia Tech.

Matthew D. Clift joined Tempur-Pedic International in December 2004 and serves as Executive Vice President of Global Operations, with responsibilities including manufacturing and research and development. From 1991 to December 2004, Mr. Clift was employed by Lexmark International where he most recently served as Vice President and General Manager of the consumer printer division. From 1981 to 1991, Mr. Clift was employed by IBM Corporation and held several management positions in research and development and manufacturing. Mr. Clift obtained his B.S. degree in chemical engineering from the University of Kentucky.

Lou H. Jones joined Tempur-Pedic International in June 2009 and serves as Executive Vice President, General Counsel and Secretary. From July 2007 to January 2009, Ms. Jones was employed by Papa John's International, where she served as General Counsel. From March 1998 to July 2007, Ms. Jones was employed by Blockbuster Inc., serving as Senior Vice President, Corporate and International Law. From May 1984 to March 1998, Ms. Jones was a partner and shareholder at the law firm of Thompson & Knight. Ms. Jones earned a B.A. degree from the University of Texas, a B.G.S. degree from the University of Nebraska and a J.D. degree from Southern Methodist University.

David Montgomery joined Tempur-Pedic International in February 2003 and serves as Executive Vice President and President of International Operations, with responsibilities including marketing and sales. From 2001 to November 2002, Mr. Montgomery was employed by Rubbermaid, Inc., where he served as President of Rubbermaid Europe. From 1988 to 2001, Mr. Montgomery held various management positions at Black & Decker Corporation, most recently as Vice President of Black & Decker Europe, Middle East and Africa. Mr. Montgomery received his B.A. degree, with honors, from L' Ecole Supérieure de Commerce de Reims, France and Middlesex Polytechnic, London.

Brad Patrick joined Tempur-Pedic International in September 2010 and serves as Executive Vice President and Chief Human Resources Officer. From 2005 to September 2010, Mr. Patrick was employed by the Sara Lee Corporation where he served as Senior Vice President of Human Resources. Mr. Patrick was employed by The Gillette Company from 2004 to 2005, which later became part of The Procter & Gamble Company, Delta Air Lines from 2000 to 2004 and Frito Lay, Inc. from 1988 to 2000 where he held several senior human resources positions. Mr. Patrick received his B.A. from the University of Kentucky with an emphasis in Personnel and Industrial Relations.

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Bhaskar Rao joined Tempur-Pedic International in January 2004 and since April 2011 has served as Senior Vice President Finance and Chief Accounting Officer. From February 2010 to April 2011, Mr. Rao served as Senior Vice President of Strategic Planning and Corporate Development and Chief Accounting Officer. From May 2006 to February 2011, Mr. Rao served as Vice President of Strategic Planning and Chief Accounting Officer. From October 2005 to May 2006, Mr. Rao served as Vice President of Strategic Planning. From January 2004 to October 2005, he served as Director of Financial Planning and Analysis. From 2002 until December 2003, Mr. Rao was employed by Ernst & Young LLP as a Senior Manager in the assurance and business advisory group. Mr. Rao was employed by Arthur Andersen LLP from 1994 until 2002. Mr. Rao graduated from Bellarmine University with B.A. degrees in Accounting and Economics. Mr. Rao is also a Certified Public Accountant.

ITEM 1A. RISK FACTORS

The following risk factors and other information included in this report should be carefully considered. Please also see “Special Note Regarding Forward-Looking Statements” on page i.

Unfavorable economic and market conditions could reduce our sales and profitability and as a result, our operating results may be adversely affected.

Our business has been affected by general business and economic conditions, and these conditions could have an impact on future demand for our products. Although demand in the U.S. mattress industry, and in our business particularly, improved in 2011, the U.S. macroeconomic environment remains uncertain and was the primary factor in a slowdown in the mattress industry starting in 2008. In addition, our International segment experienced weakening as a result of general business and economic conditions. The global economy remains unstable, and we expect the economic environment to continue to be challenging as continued economic uncertainty has generally given households less confidence to make discretionary purchases.

In particular, the financial crisis that affected the banking system and financial markets and the current uncertainty in global economic conditions have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets and volatility in credit, equity and fixed income markets. There could be a number of other effects from these economic developments on our business, including reduced consumer demand for products; insolvency of our customers, resulting in increased provisions for credit losses; insolvency of our key suppliers resulting in product delays; inability of retailers and consumers to obtain credit to finance purchases of our products; decreased consumer confidence; decreased retail demand, including order delays or cancellations; and counterparty failures negatively impacting our treasury operations.

In addition, the negative worldwide economic conditions and market instability makes it increasingly difficult for us, our customers and our suppliers to accurately forecast future product demand trends, which could cause us to produce excess products that can increase our inventory carrying costs. Alternatively, this forecasting difficulty could cause a shortage of products, or materials used in our products, that could result in an inability to satisfy demand for our products and a loss of market share.

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Our sales growth is dependent upon our ability to implement strategic initiatives and actions taken to increase sales growth may not be effective.

Our ability to generate sales growth is dependent upon a number of factors, including the following:

our ability to continuously improve our products to offer new and enhanced consumer benefits and better quality;

our recent product launches significantly increased Net sales; however, future product launches may not be as successful;

the effectiveness of our advertising campaigns and other marketing programs in building product and brand awareness, driving traffic to our distribution channels and increasing sales;

our ability to continue to successfully execute our strategic initiatives;

the level of consumer acceptance of our products; and

general economic factors that negatively impact consumer confidence, disposable income or the availability of consumer financing.

Over the last few years, we have had to manage our business both through periods of rapid growth and the uncertain economic environment. A source of our growth within this time frame has been through expanding distribution of our products into new stores, principally furniture and bedding retail stores in the U.S. Our products are currently sold in approximately 7,900 furniture and bedding retail stores in North America, and our plan is to increase our total penetration to a total of 9,000 to 10,000 over the long term. Our products are sold in approximately 5,200 retail stores internationally, out of a total of 8,000 that have been identified as appropriate targets. Some of these retail stores may undergo restructurings, experience financial difficulty or realign their affiliations, which could decrease the number of stores that carry our products. Our sales growth will increasingly depend on our ability to generate additional sales in our existing accounts in the Retail channel. If we are unable to increase product sales in our existing retail accounts at a sufficient rate overall, our Net sales growth could slow, which could adversely affect the price of our common stock.

In addition, we may seek to acquire an additional business or businesses in order to increase sales growth, and any acquisition could be disruptive to our ongoing business, create integration issues, require additional borrowings or share issuances, or create other risks for our business.

We operate in the highly competitive mattress and pillow industries, and if we are unable to compete successfully, we may lose customers and our sales may decline.

Participants in the mattress and pillow industries compete primarily on price, quality, brand name recognition, product availability and product performance. Our premium mattresses compete with a number of different types of mattress alternatives, including standard innerspring mattresses, viscoelastic mattresses, foam mattresses, waterbeds, futons, air beds and other air-supported mattresses. These alternative products are sold through a variety of channels, including furniture and bedding stores, department stores, mass merchants, wholesale clubs, telemarketing programs, television infomercials and catalogs.

Our largest competitors have significant financial, marketing and manufacturing resources. They enjoy strong brand name recognition, and sell their products through broad and well established distribution channels. Additionally, a number of our significant competitors offer non-innerspring mattress and viscoelastic pillow products. Any such

competition by established manufacturers or new entrants into the market could have a material adverse effect on our business, financial condition and operating results. The pillow industry is characterized by a large number of competitors, none of which are dominant, but many of which have greater resources than us.

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Because we depend on our significant customers, a decrease or interruption in their business with us would reduce our sales and profitability.

Our top five customers, collectively, accounted for approximately 20.0% of our Net sales for the year ended December 31, 2011. Many of our customer arrangements are by purchase order or are terminable at will at the option of either party. We expect that some of our retailers may consolidate, undergo restructurings or reorganizations, experience financial difficulty, or realign their affiliations, any of which could decrease the number of stores that carry our products or increase the ownership concentration in the retail industry. Some of these retailers may decide to carry only a limited number of brands of mattress products, which could affect our ability to sell our products to them on favorable terms, if at all. A substantial decrease or interruption in business from our significant customers could result in the loss of future business and could reduce our liquidity and profitability.

We are subject to fluctuations in the cost of raw materials, and increases in these costs would reduce our liquidity and profitability.

The major raw materials that we purchase for production are chemicals and proprietary additives, which are influenced by oil prices. The price and availability of these raw materials are subject to market conditions affecting supply and demand. We experienced increases in the price of certain raw materials during 2011 and, we expect to encounter inflationary costs for raw materials in 2012. To the extent we are unable to absorb those higher costs, or pass any such higher costs to our customers, our gross profit margin could be negatively affected, which could result in a decrease in our liquidity and profitability.

We are subject to a pending tax proceeding in Denmark, and an adverse decision would reduce our liquidity and profitability.

During the fourth quarter of 2007, we received an income tax assessment from the Danish Tax Authority with respect to the 2001, 2002 and 2003 tax years and an assessment with respect to the 2004 tax year during the third quarter of 2010, and an assessment with respect to the 2005 tax 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 \$103.1 million including interest and penalties. We 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, we filed the Bilateral APA with the IRS and the Danish Tax Authority. The IRS began analyzing the Bilateral APA in the first quarter of 2009 and completed their review during the fourth quarter of 2010. The U.S. and Danish competent authorities met to discuss the Company's Bilateral APA during the first quarter 2011 and fourth quarter 2011. An adverse decision could reduce or impair our liquidity and profitability.

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We may be unable to sustain our profitability, which could impair our ability to service our indebtedness and make investments in our business and could adversely affect the market price for our stock.

Our ability to service our indebtedness depends on our ability to maintain our profitability. We may not be able to maintain our profitability on a quarterly or annual basis in future periods. Further, our profitability will depend upon a number of factors, including without limitation:

general economic conditions in the markets in which we sell our products and the impact on consumers and retailers;

the level of competition in the mattress and pillow industry;

our ability to align our cost structure with sales in the existing economic environment;

our ability to effectively sell our products through our distribution channels in volumes sufficient to drive growth and leverage our cost structure and advertising spending;

our ability to reduce costs;

our ability to absorb fluctuations in commodity costs;

our ability to maintain efficient, timely and cost-effective production and utilization of our manufacturing capacity;

our ability to successfully identify and respond to emerging trends in the mattress and pillow industry; and

our ability to maintain public association of our brand with premium products, including overcoming any impact on our brand caused by some of our customers seeking to sell our products at a discount to our recommended price.

Our advertising expenditures may not result in increased sales or generate the levels of product and brand name awareness we desire and we may not be able to manage our advertising expenditures on a cost-effective basis.

A significant component of our marketing strategy involves the use of direct marketing to generate sales. Future growth and profitability will depend in part on the cost and efficiency of our advertising expenditures, including our ability to create greater awareness of our products and brand name and determine the appropriate creative message and media mix for future advertising expenditures.

Our operating results are increasingly subject to fluctuations, which could adversely affect the market price of our common stock.

A significant portion of our growth in Net sales is attributable to growth in sales in our North American Retail channel, particularly Net sales to furniture and bedding stores. We believe that our sales of mattresses and pillows to furniture and bedding stores are subject to seasonality inherent in the bedding industry, with sales expected to be generally lower in the second and fourth quarters and higher in the first and third quarters, and in Europe, lower in the third quarter. Our Net sales may be affected increasingly by this seasonality, particularly as our North American Retail sales channel continues to grow as a percentage of our overall Net sales and, to a lesser extent, by seasonality outside the North American segment.

In addition to seasonal fluctuations, the demand for our premium products can fluctuate significantly based on a number of other factors, including general economic conditions, consumer confidence, the timing of price increases announced by us or our competitors and promotions we offer or offered by our competitors. As our consumer base continues to expand across a wider demographic, it may be comprised of a greater percentage of middle income consumers. As a result, our consumer base may be more susceptible to general economic factors impacted by decreased disposable income, consumer confidence or availability of consumer financing.



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We may be adversely affected by fluctuations in exchange rates, which could affect our results of operations, the costs of our products and our ability to sell our products in foreign markets.

Approximately 29.1% of our Net sales were generated by our International segment for the year ended December 31, 2011. As a multinational company, we conduct our business in a wide variety of currencies and are therefore subject to market risk for changes in foreign exchange rates. We use foreign exchange forward contracts to manage a portion of the exposure to the risk of the eventual net cash inflows and outflows resulting from foreign currency denominated transactions between Tempur-Pedic International subsidiaries and their customers and suppliers, as well as among certain Tempur-Pedic International subsidiaries. The hedging transactions may not succeed in managing our foreign currency exchange rate risk. See “ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Foreign Currency Exposures” in Part II of this report.

Foreign currency exchange rate movements also create a degree of risk by affecting the U.S. dollar value of sales made and costs incurred in foreign currencies. We do not enter into hedging transactions to hedge this risk. Consequently, our reported earnings and financial position could fluctuate materially as a result of foreign exchange gains or losses. Our outlook for 2012 assumes modest unfavorable currency exchange rates versus the full year ended December 31, 2011. Should currency rates change sharply, our results could be negatively impacted. See “ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Foreign Currency Exposures” in Part II of this report.

We are subject to risks from our international operations, such as increased costs, which could impair our ability to compete and our profitability.

We currently conduct international operations in our 20 wholly-owned subsidiaries and our products are sold in approximately 80 countries. We generated approximately 29.1% of our Net sales from our International segment during the year ended December 31, 2011, and we continue to pursue additional international opportunities. Our international operations are subject to the customary risks of operating in an international environment, including complying with foreign laws and regulations and the potential imposition of trade or foreign exchange restrictions, tariffs and other tax increases, fluctuations in exchange rates, inflation and unstable political situations and labor issues.

If we are not able to protect our trade secrets or maintain our trademarks, patents and other intellectual property, we may not be able to prevent competitors from developing similar products or from marketing in a manner that capitalizes on our trademarks, and this loss of a competitive advantage could decrease our profitability and liquidity.

We rely on trade secrets to protect the design, technology and function of our TEMPUR® material and our products. To date, we have not sought U.S. or international patent protection for our principal product formula and manufacturing processes. Accordingly, we may not be able to prevent others from developing viscoelastic material and products that are similar to or competitive with our products. Our ability to compete effectively with other companies also depends, to a significant extent, on our ability to maintain the proprietary nature of our owned and licensed intellectual property. We own several patents on aspects of our products and have patent applications pending on aspects of our products and manufacturing processes. However, the principal product formula and manufacturing processes for our TEMPUR® material and our products are not patented and we must maintain these as trade secrets in order to protect this intellectual property. We own U.S. and foreign registered trade names and servicemarks and have applications for the registration of trade names and servicemarks pending domestically and abroad. We also license certain intellectual property rights from third parties.



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Our trademarks are currently registered in the U.S. and registered or pending in foreign jurisdictions. However, those rights could be circumvented, or violate the proprietary rights of others, or we could be prevented from using them if challenged. A challenge to our use of our trademarks could result in a negative ruling regarding our use of our trademarks, their validity or their enforceability, or could prove expensive and time consuming in terms of legal costs and time spent defending against such a challenge. Any loss of trademark protection could result in a decrease in sales or cause us to spend additional amounts on marketing, either of which could decrease our liquidity and profitability. In addition, if we incur significant costs defending our trademarks, that could also decrease our liquidity and profitability. In addition, we may not have the financial resources necessary to enforce or defend our trademarks. Furthermore, our patents may not provide meaningful protection and patents may never issue from pending applications. It is also possible that others could bring claims of infringement against us, as our principal product formula and manufacturing processes are not patented, and that any licenses protecting our intellectual property could be terminated. If we were unable to maintain the proprietary nature of our intellectual property and our significant current or proposed products, this loss of a competitive advantage could result in decreased sales or increased operating costs, either of which would decrease our liquidity and profitability.

In addition, the laws of certain foreign countries may not protect our intellectual property rights and confidential information to the same extent as the laws of the U.S. or the European Union. Third parties, including competitors, may assert intellectual property infringement or invalidity claims against us that could be upheld. Intellectual property litigation, which could result in substantial cost to and diversion of effort by us, may be necessary to protect our trade secrets or proprietary technology, or for us to defend against claimed infringement of the rights of others and to determine the scope and validity of others' proprietary rights. We may not prevail in any such litigation, and if we are unsuccessful, we may not be able to obtain any necessary licenses on reasonable terms or at all.

An increase in our product return rates or an inadequacy in our warranty reserves could reduce our liquidity and profitability.

Part of our North American marketing and advertising strategy in certain North American channels focuses on providing up to a 120-day money back guarantee under which customers may return their mattress and obtain a refund of the purchase price. For the years ended December 31, 2011 and 2010, we had approximately \$46.7 million and \$44.6 million in returns for a return rate of approximately 4.6% and 5.8%, respectively, of our Net sales in North America. As we expand our sales, our return rates may not remain within our historical levels. A downturn in general economic conditions may also increase our product return rates. An increase in return rates could significantly impair our liquidity and profitability.

We also currently provide our customers with a limited, pro-rata 20-year warranty on mattresses sold in North America and a limited, pro-rata 15-year warranty on mattresses sold in the International segment. However, as we have only been selling mattresses in significant quantities since 1992, and have released new products in recent years, many of which are fairly early in their product life cycles. We also provide 2-year to 3-year warranties on pillows.

Because not all of our products have been in use by our customers for the full warranty period, we rely on the combination of historical experience and product testing for the development of our estimate for warranty claims. However, our actual level of warranty claims could prove to be greater than the level of warranty claims we estimated based on our products' performance during product testing. If our warranty reserves are not adequate to cover future warranty claims, their inadequacy could have a material adverse effect on our liquidity and profitability.

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We are vulnerable to interest rate risk with respect to our debt, which could lead to an increase in interest expense.

We are subject to interest rate risk in connection with the variable rate debt under our credit facility (Senior Credit Facility). Interest rate changes could increase the amount of our interest payments and thus, negatively impact our future earnings and cash flows. We estimate that our annual interest expense on our floating rate indebtedness would increase by \$3.4 million for each 1.0% increase in interest rates. See “ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Interest Rate Risk” in Part II of this report.

Our leverage may limit our flexibility and increase our risk of default.

As of December 31, 2011, we had \$585.0 million in total Long-term debt outstanding. In addition, as of December 31, 2011, our Stockholders’ Equity was \$30.8 million. During 2011 we repurchased a total of \$368.5 million in common stock pursuant to stock repurchase authorizations approved by our Board of Directors. We funded the repurchases in part through borrowings under our Senior Credit Facility, which increased our leverage. On January 23, 2012, the Company's Board of Directors terminated the remaining authority under the July 2011 authorization, as amended in October 2011, and approved a new share repurchase authorization of up to \$250.0 million of the Company's common stock.

Our degree of leverage could have important consequences to our investors, such as:

limiting our ability to obtain additional financing we may need to fund future working capital, capital expenditures, product development, acquisitions or other corporate requirements; and

requiring the dedication of a substantial portion of our cash flow from operations to the payment of principal and interest on our debt, which would reduce the availability of cash flow to fund working capital, capital expenditures, product development, acquisitions and other corporate requirements.

In addition, the instruments governing our debt contain financial and other restrictive covenants, which limit our operating flexibility and could prevent us from taking advantage of business opportunities. Our failure to comply with these covenants may result in an event of default. If such event of default is not cured or waived, we may suffer adverse effects on our operations, business or financial condition, including acceleration of our debt. For further discussion regarding our debt covenants and compliance, see “ITEM 7. Management’s discussion and analysis of financial condition and results of operations—Liquidity and capital resources” in Part II of this report.

Loss of suppliers and disruptions in the supply of our raw materials could increase our costs of sales and reduce our ability to compete effectively.

We acquire chemicals and proprietary additives from a number of suppliers with manufacturing locations around the world. If we were unable to obtain chemicals and proprietary additives from these suppliers, we would have to find replacement suppliers. Any substitute arrangements for chemicals and proprietary additives might not be on terms as favorable to us. In addition, we continue to outsource the procurement of certain goods and services, particularly mattress and pillow covers and adjustable bed bases, from suppliers in foreign countries. If we were no longer able to outsource through these suppliers, we could source it elsewhere, perhaps at a higher cost. In addition, if one of our major suppliers, or several of our suppliers, declare bankruptcy or otherwise cease operations, our supply chain could be materially disrupted. We maintain relatively small supplies of our raw materials and outsourced goods at our manufacturing facilities, and any disruption in the on-going shipment of supplies to us could interrupt production of our products, which could result in a decrease of our sales or could cause an increase in our cost of sales, either of which could decrease our liquidity and profitability.



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We rely significantly on information technology and any failure, inadequacy, interruption or security lapse of that technology could harm our ability to effectively operate our business.

Our ability to effectively manage our business depends significantly on our information systems. The failure of our current systems, or future upgrades, to operate effectively or to integrate with other systems, or a breach in security of these systems could cause reduced efficiency of our operations, and remediation of any such failure, problem or breach could reduce our liquidity and profitability.

We produce our products in three manufacturing facilities, and unexpected equipment failures, delays in deliveries or catastrophic loss delays may lead to production curtailments or shutdowns.

We manufacture our products at our three facilities: in Aarup, Denmark, Duffield, Virginia and Albuquerque, New Mexico. An interruption in production capabilities at any of these plants as a result of equipment failure could result in our inability to produce our products, which would reduce our sales and earnings for the affected period. For example, we produce pillows for our North American segment only at our Duffield, Virginia facility. An interruption in pillow production capabilities at this plant could result in a disruption of pillow distribution to the market. In addition, we generally deliver our products only after receiving the order from the customer or the retailer and thus do not hold significant levels of inventories. In the event of a disruption in production at any of our manufacturing facilities, even if only temporary, or if we experience delays as a result of events that are beyond our control, delivery times could be severely affected. For example, a third party carrier could potentially be unable to deliver our products within acceptable time periods due to a labor strike or other disturbance in its business. Any significant delay in deliveries to our customers could lead to increased returns or cancellations and cause us to lose future sales. Any increase in freight charges could increase our costs of doing business and affect our profitability. We have introduced new distribution programs to increase our ability to deliver products on a timely basis, but if we fail to deliver products on a timely basis, we may lose sales which could decrease our liquidity and profitability. Our manufacturing facilities are also subject to the risk of catastrophic loss due to unanticipated events such as fires, explosions or violent weather conditions. Despite the fact that we maintain insurance covering the majority of these risks, we may in the future experience material plant shutdowns or periods of reduced production as a result of equipment failure, delays in deliveries or catastrophic loss.

The loss of the services of any members of our senior management team could impair our ability to execute our business strategy and as a result, reduce our sales and profitability.

We depend on the continued services of our senior management team. The loss of key personnel could have a material adverse effect on our ability to execute our business strategy and on our financial condition and results of operations. We do not maintain key-person insurance for members of our senior management team.

Deterioration in labor relations could disrupt our business operations and increase our costs, which could decrease our liquidity and profitability.

As of December 31, 2011, we had approximately 1,800 full-time employees, with approximately 800 in North America, 300 in Denmark and 700 in the rest of the world. Certain of our employees in Denmark are under a government labor union contract, but those in the U.S. are not. Any significant increase in our labor costs could decrease our liquidity and profitability and any deterioration of employee relations, slowdowns or work stoppages at any of our locations, whether due to union activities, employee turnover or otherwise, could result in a decrease in our Net sales or an increase in our costs, either of which could decrease our liquidity and profitability.



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We may face exposure to product liability claims, which could reduce our liquidity and profitability and reduce consumer confidence in our products.

We face an inherent business risk of exposure to product liability claims if the use of any of our products results in personal injury or property damage. In the event that any of our products prove to be defective, we may be required to recall, redesign or even discontinue those products. We maintain insurance against product liability claims, but such coverage may not continue to be available on terms acceptable to us or be adequate for liabilities actually incurred. A successful claim brought against us in excess of available insurance coverage could impair our liquidity and profitability, and any claim or product recall that results in significant adverse publicity against us could result in consumers purchasing fewer of our products, which would also impair our liquidity and profitability.

Regulatory requirements may require costly expenditures and expose us to liability.

Our products and our marketing and advertising programs are and will continue to be subject to regulation in the U.S. by various federal, state and local regulatory authorities, including the Federal Trade Commission and the U.S. Food and Drug Administration. In addition, other governments and agencies in other jurisdictions regulate the sale and distribution of our products. Compliance with these regulations may have an adverse effect on our business. For example, the U.S. Consumer Product Safety Commission has adopted rules relating to fire retardancy standards for the mattress industry. We developed product modifications that allow us to meet these standards. Required product modifications have added cost to our products. Many foreign jurisdictions also regulate fire retardancy standards, and changes to these standards and changes in our products that require compliance with additional standards would raise similar risks.

Our marketing and advertising practices could also become the subject of proceedings before regulatory authorities or the subject of claims by other parties. In addition, we are subject to federal, state and local laws and regulations relating to pollution, environmental protection and occupational health and safety. We may not be in complete compliance with all such requirements at all times. We have made and will continue to make capital and other expenditures to comply with environmental and health and safety requirements. If a release of hazardous substances occurs on or from our properties or any associated offsite disposal location, or if contamination from prior activities is discovered at any of our properties, we may be held liable and the amount of such liability could be material.

Our operations could also be impacted by a number of pending legislative and regulatory proposals to address greenhouse gas emissions in the U.S. Similarly, certain countries including Denmark, where our only plant outside the United States is located, have adopted the Kyoto Protocol, and this and other international initiatives under consideration could affect our international operations. These actions could increase costs associated with our operations, including costs for raw materials and transportation. Because it is uncertain what laws will be enacted, we cannot predict the potential impact of such laws on our future consolidated financial condition, results of operations or cash flows.

Challenges to our pricing policies could adversely affect our operations.

Our retail pricing policies are subject to antitrust regulations in the U.S. and abroad. If antitrust regulators in any jurisdiction in which we do business initiate investigations into or challenge our pricing or advertising policies, our efforts to respond could force us to divert management resources and we could incur significant unanticipated costs. If such an investigation were to result in a charge that our practices or policies were in violation of applicable antitrust or other laws or regulations, we could be subject to significant additional costs of defending such charges in a variety of venues and, ultimately, if there were a finding that we were in violation of antitrust or other laws or regulations, there could be an imposition of fines, and damages for persons injured, as well as injunctive or other relief. Any requirement that we pay fines or damages could decrease our liquidity and profitability, and any investigation or claim



that requires significant management attention or causes us to change our business practices could disrupt our operations or increase our costs, also resulting in a decrease in our liquidity and profitability. An antitrust class action suit against us could result in potential liabilities, substantial costs and the diversion of our management's attention and resources, regardless of the outcome. See ITEM 3, "Legal Proceedings" in Part I of this report.

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Our stock price is likely to continue to be volatile, your investment could decline in value, and we may incur significant costs from class action litigation.

The trading price of our common stock is likely to continue to be volatile and subject to wide price fluctuations. The trading price of our common stock may fluctuate significantly in response to various factors, including but not limited to:

actual or anticipated variations in our quarterly operating results, including those resulting from seasonal variations in our business;

general economic conditions, such as unemployment, changes in short-term and long-term interest rates and fluctuations in both debt and equity capital markets;

introductions or announcements of technological innovations or new products by us or our competitors;

disputes or other developments relating to proprietary rights, including patents, litigation matters, and our ability to patent, or otherwise protect, our products and technologies;

changes in estimates by securities analysts of our financial performance;

stock repurchase programs;

bankruptcies of any of our major customers;

conditions or trends in the premium bedding industry, or the mattress industry generally;

additions or departures of key personnel;

announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

announcements by our competitors of their quarterly operating results or announcements by our competitors of their views on trends in the bedding industry;

regulatory developments in the U.S. and abroad;

economic and political factors;

public announcements or filings with the SEC indicating that significant stockholders, directors or officers are selling shares of our common stock; and

the declaration or suspension of a cash dividend.

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In addition, the stock market in general has experienced significant price and volume fluctuations that have often been unrelated or disproportionate to operating performance. These broad market factors may seriously harm the market price of our common stock, regardless of our operating performance.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit against us could result in potential liabilities, substantial costs, and the diversion of our management's attention and resources, regardless of the outcome.

Future sales of our common stock may depress our stock price.

The market price of our common stock could decline as a result of sales of substantial amounts of our common stock in the public market, or the perception that these sales could occur. In addition, these factors could make it more difficult for us to raise funds through future offerings of common stock. As of January 27, 2012, there were 63.8 million shares of our common stock outstanding. All of our shares of our common stock are freely transferable without restriction or further registration under the Securities Act of 1933, except for certain shares of our common stock which were purchased by our executive officers, directors, principal stockholders, and some related parties.

In addition, up to approximately 18.5 million shares of our common stock are reserved for grants under our 2002 Stock Option Plan, our Amended and Restated 2003 Equity Incentive Plan, as amended and our 2003 Employee Stock Purchase Plan. As of December 31, 2011, approximately 4.4 million equity awards are outstanding and 2.9 million are available for future grants. The Company has filed registration statements with the SEC with respect to these shares and stockholders can sell these shares in the public market upon issuance, subject to restrictions under the securities laws and any applicable lock-up agreements.

We have stockholders who presently beneficially own more than 5% of our outstanding capital stock. Sales or other dispositions of our shares by these major stockholders may depress our stock price.

Our current directors, officers and their affiliates own a large percentage of our common stock and could limit you from influencing corporate decisions.

As of January 27, 2012 our executive officers, directors, and their respective affiliates own, in the aggregate, approximately 4% of our outstanding common stock on a fully diluted basis, after giving effect to the vesting of all unvested options. These stockholders, as a group, are able to influence all matters requiring approval by our stockholders, including mergers, sales of assets, the election of directors, and approval of other significant corporate transactions, in a manner with which you may not agree or that may not be in your best interest. In addition, we have stockholders who own more than 5% of our outstanding common stock, and as a result, may be able to influence matters requiring the approval of stockholders and the approval of other significant corporate transactions.

Provisions of Delaware law and our charter documents could delay or prevent an acquisition of us, even if the acquisition would be beneficial to you.

Provisions of Delaware law and our certificate of incorporation and by-laws could hamper a third party's acquisition of us, or discourage a third party from attempting to acquire control of us. You may not have the opportunity to participate in these transactions. These provisions could also limit the price that investors might be willing to pay in the future for shares of our common stock.

These provisions include:

our ability to issue preferred stock with rights senior to those of the common stock without any further vote or action by the holders of our common stock;

the requirements that our stockholders provide advance notice when nominating our directors; and

the inability of our stockholders to convene a stockholders' meeting without the chairperson of the board, the president, or a majority of the board of directors first calling the meeting.

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## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Our products are sold in approximately 80 countries and we have wholly-owned subsidiaries in 22 countries, including our wholly-owned subsidiaries that own our manufacturing facilities in Denmark and the U.S. The following table sets forth certain information regarding our principal facilities at December 31, 2011.

| Name/Location  | Approximate<br>Square<br>Footage | Title               | Type of Facility     |
|--|----------------------------------|---------------------|----------------------|
| Tempur Production USA, LLC<br>Duffield, Virginia       | 540,000                          | Owned               | Manufacturing        |
| Tempur Production USA, LLC<br>Albuquerque, New Mexico  | 800,000                          | Leased (until 2035) | Manufacturing        |
| Dan-Foam ApS<br>Aarup, Denmark                         | 517,000                          | Owned               | Manufacturing        |
| Tempur-Pedic North America, LLC<br>Lexington, Kentucky | 72,000                           | Leased (until 2012) | Office               |
| Tempur Deutschland GmbH<br>Steinhagen, Germany         | 121,000                          | Owned               | Office and Warehouse |

In addition to the properties listed above, we have 33 facilities in 13 countries under leases with one to ten year terms. The manufacturing facility in Albuquerque, New Mexico is leased as part of the related industrial revenue bond financing. We have an option to repurchase the property for one dollar upon termination of the lease.

We believe that our existing properties are suitable for the conduct of our business, are adequate for our present needs and will be adequate to meet our future needs. In addition, we began construction of our new corporate headquarters in October 2011, which we expect to be completed during the fourth quarter of 2012.

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ITEM 3. LEGAL PROCEEDINGS

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 operations.

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.



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## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

## Market for Registrant's Common Equity

Our sole class of common equity is our \$0.01 par value common stock, which trades on the New York Stock Exchange (NYSE) under the symbol "TPX." Trading of our common stock commenced on the NYSE on December 18, 2003. Prior to that time, there was no public trading market for our common stock.

The following table sets forth the high and low sales prices per common share, at closing, of our common stock as reported by the NYSE and cash dividends paid per common share for the fiscal periods indicated.

|                    | Price Range |          | Cash Dividend<br>Per Common<br>Share |
|--------------------|-------------|----------|--------------------------------------|
|                    | High        | Low      |                                      |
| <b>Fiscal 2010</b> |             |          |                                      |
| First Quarter      | \$ 31.15    | \$ 24.43 | \$ —                                 |
| Second Quarter     | 35.79       | 29.65    | —                                    |
| Third Quarter      | 32.76       | 26.01    | —                                    |
| Fourth Quarter     | 40.62       | 26.88    | —                                    |
| <b>Fiscal 2011</b> |             |          |                                      |
| First Quarter      | \$ 50.74    | \$ 39.40 | \$ —                                 |
| Second Quarter     | 67.97       | 50.99    | —                                    |
| Third Quarter      | 72.24       | 51.32    | —                                    |
| Fourth Quarter     | 69.82       | 48.69    | —                                    |

As of December 31, 2011, we had approximately 123 shareholders of record of our common stock.

## Dividends

The Company did not pay any dividends in 2011 or 2010. The decision to pay a dividend in future periods is reviewed by our Board of Directors on a periodic basis.



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## Equity Compensation Plan Information

The following table sets forth equity compensation plan information as of December 31, 2011:

| Plan category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|---|---|---|
|  | (a)   | (b)   | (c)   |
| Equity compensation plans approved by security holders:    |   |   |   |
| 2002 Stock Option Plan (1)                                 | 8,869   | \$ 2.86   | —   |
| 2003 Equity Incentive Plan (2)                             | 4,436,475   | 16.89   | 2,802,428   |
| 2003 Employee Stock Purchase Plan (3)                      | —   | —   | 141,599   |
| Equity compensation plans not approved by security holders |   |   |   |
| Total  | 4,445,344   | \$ 16.85  | 2,944,027   |

- (1) In December 2003, our Board of Directors adopted a resolution that prohibited further grants under the 2002 Stock Option Plan.
- (2) The number of securities to be issued upon exercise of outstanding stock options, warrants and rights issued under the 2003 Equity Incentive Plan includes 185,296 of restricted stock units and deferred stock units. Additionally, this number includes 853,404 performance restricted stock units which reflects a maximum payout of the awards granted. These restricted, deferred and performance restricted stock units are excluded from the weighted average exercise price calculation above.
- (3) Shares under the 2003 Employee Stock Purchase Plan allows eligible employees to purchase our common stock annually over the course of two semi-annual offering periods at a price of no less than 85% of the price per share of our common stock. This plan is an open market purchase plan and does not have a dilutive effect. Effective February 1, 2010, we suspended offerings under the ESPP indefinitely.

See Note 9 to the Consolidated Financial Statements for information regarding the material features of each of the above plans.

## Issuer Purchases of Equity Securities

During 2011, we purchased 6.5 million shares of our common stock for a total cost of \$368.5 million pursuant to authorizations made by our Board of Directors. On January 23, 2012, our Board of Directors terminated the remaining authority under the July 2011 authorization, as amended in October 2011, and approved a new share repurchase authorization of up to \$250.0 million of our 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 Senior Credit Facility. This share repurchase program may be limited, suspended or terminated at any time without notice.

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The following table sets forth purchases of our common stock for the three months ended December 31, 2011:

| Period                               | (a) Total number of share purchased | (b) Average Price Paid per Share | (c) Total number of shares purchased as part of publicly announced plans or programs | (d) Maximum number of shares (or approximate dollar value) of shares that may yet be purchased under the plans or programs (in millions) |
|--------------------------------------|-------------------------------------|----------------------------------|--|--|
| October 1, 2011 – October 31, 2011   | —                                   | —                                | —  | —  |
| November 1, 2011 – November 30, 2011 | 2,097,281                           | \$ 51.21                         | 2,097,281  | \$ 80.0  |
| December 1, 2011 – December 31, 2011 | 162,975                             | 51.17                            | 162,975  | 71.5   |
| Total                                | 2,260,256                           |                                  | 2,260,256  |  |

## Performance Graph

The following Performance Graph and related information shall not be deemed to be “soliciting material” or to be “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

The following table compares cumulative shareholder returns for the Company over the last five years to the Standard & Poor’s (S&P) 500 Stock Composite Index, and a peer group. The S&P 500 Composite Index is a capitalization weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the U.S. economy, and are chosen for market size, liquidity and industry group representation. We believe the peer group closely reflects our business and, as a result, provides meaningful comparison of stock performance.

The peer issuers included in this graph are set forth below:

|                                      |                              |                                 |
|--------------------------------------|------------------------------|---------------------------------|
| Callaway Golf Company                | Herman Miller Inc.           | Steelcase Inc.                  |
| Coach, Inc.                          | Krispy Kreme Doughnuts, Inc. | Tempur-Pedic International Inc. |
| Columbia Sportswear Company          | Nautilus, Inc.               | Tiffany & Co.                   |
| Ethan Allen Interiors Inc.           | Ralph Lauren Corp.           | Tupperware Brands Corp.         |
| Fossil, Inc.                         | Quiksilver, Inc.             |                                 |
| Harman International Industries Inc. | Select Comfort Corp.         |                                 |

The comparison for each of the periods assumes that \$100 was invested on December 31, 2006 in our common stock, the stocks included in the S&P 500 Composite Index and the stocks included in each peer group index and that all dividends were reinvested. The stock performance shown on the graph below is not necessarily indicative of future price performance.

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|                                  | 12/2006   | 12/2007   | 12/2008  | 12/2009   | 12/2010   | 12/2011   |
|----------------------------------|-----------|-----------|----------|-----------|-----------|-----------|
| Tempur-Pedic International, Inc. | \$ 100.00 | \$ 128.36 | \$ 35.75 | \$ 119.14 | \$ 201.98 | \$ 264.85 |
| S&P 500                          | 100.00    | 105.49    | 66.46    | 84.05     | 96.71     | 98.75     |
| Peer Group                       | 100.00    | 86.58     | 45.97    | 81.42     | 122.25    | 134.34    |

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## ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial and operating data for the periods indicated. We have derived our statements of income and balance sheet data as of and for the years ended December 31, 2011, 2010, 2009, 2008 and 2007 from our audited financial statements. Our financial statements as of December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011 are included in ITEM 15, "Exhibits and Financial Statement Schedules" in Part IV of this report.

(In thousands, except par share amounts)

| Statement of Income Data:   | 2011         | 2010         | 2009       | 2008       | 2007         |
|-----------------------------|--------------|--------------|------------|------------|--------------|
| Net sales                   | \$ 1,417,938 | \$ 1,105,421 | \$ 831,156 | \$ 927,818 | \$ 1,106,722 |
| Cost of sales               | 674,848      | 549,994      | 437,414    | 526,861    | 571,896      |
| Gross profit                | 743,090      | 555,427      | 393,742    | 400,957    | 534,826      |
| Operating expenses          | 402,559      | 309,525      | 248,797    | 267,093    | 290,712      |
| Operating income            | 340,531      | 245,902      | 144,945    | 133,864    | 244,114      |
| Interest expense, net       | (11,948 )    | (14,501 )    | (17,349 )  | (25,123 )  | (30,484 )    |
| Other (expense) income, net | (192 )       | (536 )       | 441        | (1,319 )   | (756 )       |
| Income before income taxes  | 328,391      | 230,865      | 128,037    | 107,422    | 212,874      |
| Income tax provision        | 108,783      | 73,720       | 43,044     | 48,554     | 71,415       |
| Net income                  | \$ 219,608   | \$ 157,145   | \$ 84,993  | \$ 58,868  | \$ 141,459   |

Balance Sheet Data (at end of period):

|                            |            |           |           |           |           |
|----------------------------|------------|-----------|-----------|-----------|-----------|
| Cash and cash equivalents  | \$ 111,367 | \$ 53,623 | \$ 14,042 | \$ 15,385 | \$ 33,315 |
| Total Assets               | 828,640    | 716,003   | 643,379   | 646,531   | 806,432   |
| Total debt                 | 585,000    | 407,000   | 297,470   | 419,341   | 602,044   |
| Total Stockholders' Equity | 30,791     | 126,033   | 172,293   | 72,443    | 48,138    |

Other Financial and Operating Data:

|  |            |            |            |            |           |
|--|------------|------------|------------|------------|-----------|
| Dividends per common share                   | \$ —       | \$ —       | \$ —       | \$ 0.24    | \$ 0.30   |
| Depreciation and amortization <sup>(1)</sup> | 50,988     | 43,969     | 40,213     | 40,797     | 40,142    |
| Net cash provided by operating activities    | 248,706    | 184,122    | 134,986    | 198,394    | 126,361   |
| Net cash used by investing activities        | (36,076 )  | (37,517 )  | (14,303 )  | (5,368 )   | (22,871 ) |
| Net cash used by financing activities        | (148,870 ) | (106,376 ) | (118,721 ) | (200,150 ) | (87,642 ) |
| Basic earnings per common share              | 3.27       | 2.23       | 1.13       | 0.79       | 1.77      |
| Diluted earnings per common share            | 3.18       | 2.16       | 1.12       | 0.79       | 1.74      |
| Capital expenditures                         | 29,466     | 18,141     | 14,303     | 10,494     | 16,149    |

(1) Includes \$16.7 million, \$11.6 million, \$8.8 million, \$8.0 million, and \$6.7 million in non-cash stock-based compensation expense related to restricted stock units, performance restricted stock units, deferred stock units and stock options in 2011, 2010, 2009, 2008, and 2007, respectively.



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

The following discussion and analysis should be read in conjunction with "ITEM 6. Selected Financial Data" in Part I of this report and the audited consolidated financial statements and accompanying notes thereto included elsewhere in this report. Unless otherwise noted, all of the financial information in this report is consolidated financial information for the Company. 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 are subject to numerous risks and uncertainties. See "Special Note Regarding Forward-Looking Statements" and "ITEM 1A. Risk Factors" in Part I of this report. Our actual results may differ materially from those contained in any forward-looking statements.

In this discussion and analysis, we discuss and explain the consolidated financial condition and results of operations for Tempur-Pedic International for the years ended December 31, 2011, 2010 and 2009 including the following topics:

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.

Business 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 in each operating business segment: Retail (furniture and bedding, non-spring and department stores); Direct (direct response, internet and company-owned stores); Healthcare (hospitals, nursing homes, healthcare professionals and medical retailers); 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. Prior to 2011, these sales have not been material 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 Segments. 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 and 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 operating segment. We evaluate segment performance based on Net sales and Operating income.

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.



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For a further discussion of factors that could impact operating results, including the current economic environment and the steps we are taking to address this environment, see the section entitled "Factors That May Affect Future Performance" included within this section and "Risk Factors" in ITEM 1A, which are incorporated herein by reference.

### Strategy

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® mattress – 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 introduce new products.

Make sure that Tempur-Pedic® products are available to everyone – we plan to expand our points of distribution and the effectiveness of our distribution channels.

Make sure that Tempur-Pedic® bedding products continue 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 year ended December 31, 2011 include:

Earnings per common share (EPS) were \$3.18 per diluted share compared to \$2.16 for the full year 2010.

Net sales increased to \$1.4 billion compared to \$1.1 billion for the full year 2010.

Our Gross Profit margin was 52.4% compared to 50.2% for the year ended December 31, 2010.

Our Operating income margin was 24.0% compared to 22.2% for the year ended December 31, 2010.

During the year ended December 31, 2011, we generated \$248.7 million of operating cash flow compared to \$184.1 million for the year ended December 31, 2010.

During the year ended December 31, 2011, we repurchased 6.5 million shares of our common stock for a total cost of \$368.5 million.

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The following table sets forth the various components of our Consolidated Statements of Income, and expresses each component as a percentage of Net sales:

| (In thousands, except earnings per share)   | Year Ended December 31, |        |              |        |            |        |
|---|-------------------------|--------|--------------|--------|------------|--------|
|   | 2011                    |        | 2010         |        | 2009       |        |
| Net sales                                   | \$ 1,417,938            | 100.0% | \$ 1,105,421 | 100.0% | \$ 831,156 | 100.0% |
| Cost of sales                               | 674,848                 | 47.6   | 549,994      | 49.8   | 437,414    | 52.6   |
| Gross Profit                                | 743,090                 | 52.4   | 555,427      | 50.2   | 393,742    | 47.4   |
| Selling and marketing expenses              | 276,870                 | 19.5   | 199,722      | 18.1   | 153,440    | 18.5   |
| General, administrative and other           | 125,689                 | 8.9    | 109,803      | 9.9    | 95,357     | 11.5   |
| Operating income                            | 340,531                 | 24.0   | 245,902      | 22.2   | 144,945    | 17.4   |
| Interest expense, net                       | (11,948)                | (0.8)  | (14,501)     | (1.3)  | (17,349)   | (2.1)  |
| Other (expense) income, net                 | (192)                   | —      | (536)        | —      | 441        | 0.1    |
| Income before income taxes                  | 328,391                 | 23.2   | 230,865      | 20.9   | 128,037    | 15.4   |
| Income tax provision                        | 108,783                 | 7.7    | 73,720       | 6.7    | 43,044     | 5.2    |
| Net income                                  | \$ 219,608              | 15.5%  | \$ 157,145   | 14.2%  | \$ 84,993  | 10.2%  |
| Earnings per common share:                  |                         |        |              |        |            |        |
| Diluted                                     | \$ 3.18                 |        | \$ 2.16      |        | \$ 1.12    |        |
| Weighted average common shares outstanding: |                         |        |              |        |            |        |
| Diluted                                     | 69,149                  |        | 72,792       |        | 76,048     |        |

Year Ended December 31, 2011 Compared with Year Ended December 31, 2010

A summary of Net sales, by channel and by segment, is set forth below:

| (in thousands) | CONSOLIDATED |              | NORTH AMERICA |            | INTERNATIONAL |            |
|----------------|--------------|--------------|---------------|------------|---------------|------------|
|                | Year Ended   |              | Year Ended    |            | Year Ended    |            |
|                | December 31, |              | December 31,  |            | December 31,  |            |
|                | 2011         | 2010         | 2011          | 2010       | 2011          | 2010       |
| Retail         | \$ 1,245,592 | \$ 953,191   | \$ 917,580    | \$ 694,725 | \$ 328,012    | \$ 258,466 |
| Direct         | 100,088      | 73,687       | 75,987        | 59,668     | 24,101        | 14,019     |
| Healthcare     | 34,060       | 35,166       | 11,168        | 12,290     | 22,892        | 22,876     |
| Third party    | 38,198       | 43,377       | —             | 5,343      | 38,198        | 38,034     |
|                | \$ 1,417,938 | \$ 1,105,421 | \$ 1,004,735  | \$ 772,026 | \$ 413,203    | \$ 333,395 |

A summary of Net sales, by product and by segment, is set forth below:

| (in thousands) | CONSOLIDATED |              | NORTH AMERICA |            | INTERNATIONAL |            |
|----------------|--------------|--------------|---------------|------------|---------------|------------|
|                | Year Ended   |              | Year Ended    |            | Year Ended    |            |
|                | December 31, |              | December 31,  |            | December 31,  |            |
|                | 2011         | 2010         | 2011          | 2010       | 2011          | 2010       |
| Mattresses     | \$ 944,349   | \$ 735,586   | \$ 693,407    | \$ 539,199 | \$ 250,942    | \$ 196,387 |
| Pillows        | 151,688      | 130,564      | 75,569        | 65,728     | 76,119        | 64,836     |
| Other          | 321,901      | 239,271      | 235,759       | 167,099    | 86,142        | 72,172     |
|                | \$ 1,417,938 | \$ 1,105,421 | \$ 1,004,735  | \$ 772,026 | \$ 413,203    | \$ 333,395 |



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Net sales. Net sales for the year ended December 31, 2011 increased to \$1.4 billion from \$1.1 billion, an increase of \$312.5 million, or 28.3%. We believe our revenues have continued gaining momentum primarily as a result of investments made in marketing, the ongoing success of new product introductions and expanding points of distribution. Consolidated Mattress sales increased \$208.8 million, or 28.4%, compared to the full year 2010. The increase in Mattress sales occurred primarily in our Retail channel with Net Sales increasing to \$1.2 billion from \$953.2 million in the same period in 2010, an increase of \$292.4 million, or 30.7%. Consolidated Pillow sales increased approximately \$21.1 million, or 16.2% compared to the year ended December 31, 2010. Consolidated Other, which primarily includes adjustable bed bases and foundations, increased \$82.6 million, or 34.5%. Many of our Pillows and Other products are sold with mattress purchases. Therefore, when Mattress sales increase, Pillows and Other products are also impacted. Direct sales increased \$26.4 million, or 35.8%. The principal factors that impacted Net sales for each segment are discussed below, in the respective segment discussion.

North America. North American Net sales for the year ended December 31, 2011 increased to \$1.0 billion from \$772.0 million for the same period in 2010, an increase of \$232.7 million, or 30.1%. Our North American Retail channel contributed \$917.6 million in Net sales for the twelve months ended December 31, 2011, for an increase of \$222.9 million, or 32.1%. The TEMPUR-Cloud® collection continues to be well received by retailers and consumers. This latest generation of proprietary TEMPUR® material was developed for consumers who want a soft sleep surface with the underlying support provided by a Tempur-Pedic mattress. In the second quarter of 2011, we introduced the TEMPUR-Contour® collection of mattresses that replaced our TEMPUR® collection for those consumers who prefer the traditional TEMPUR® feel. Additionally, we believe that our continued advertising investments have had a positive impact on our performance. As a result, North American Mattress sales increased \$154.2 million, or 28.6%, over the same period in 2010, driven by the increase in our Retail channel. Net sales in the Direct channel increased by \$16.3 million, or 27.3%. We believe increased sales in the Direct channel are a result of our focus on building brand awareness and encouraging consumers to visit our website through our advertisements. The Third Party channel Net Sales decrease is attributable to our April 1, 2010 acquisition of our third-party distributor in Canada. Other Net sales increased \$68.7 million, or 41.1%, compared to the same period in 2010. Many of our Other products are sold with mattress purchases. Therefore, when Mattress sales increase, Other products are also impacted. Additionally, we have emphasized adjustable bed bases and are experiencing improved attach rates, which are sold at a higher price point than traditional foundations.

International. International Net sales for the year ended December 31, 2011 increased to \$413.2 million from \$333.4 million for the same period in 2010, an increase of \$79.8 million, or 23.9%. On a constant currency basis, our International sales increased approximately 15.7%. The International Retail channel increased \$69.5 million, or 26.9%, for the year ended December 31, 2011. International Retail increased primarily due to the introduction of the TEMPUR-Cloud®, which we believe appeals to a different group of consumers, in our International markets. Additionally, Retail increased due to expanding points of distribution, investments in our brand awareness and growth in key customers. As a result, International Mattress sales in 2011 increased \$54.6 million, or 27.8%, compared to 2010. Pillow sales in 2011 increased \$11.3 million, or 17.4%, as compared to 2010. Other product Net sales increased \$14.0 million, or 19.4%, as compared to 2010. Many of our Pillows and Other products are sold with mattress purchases. Therefore, when Mattress sales increase, Pillows and Other products are also impacted.

Gross profit. Gross profit for the year ended December 31, 2011 increased to \$743.1 million from \$555.4 million for the same period in 2010, an increase of \$187.7 million, or 33.8%. Gross profit margin for the year ended December 31, 2011 was 52.4%, as compared to 50.2% in the same period of 2010. Our Gross profit margin is impacted by, among other factors, geographic mix between segments. Additionally, our gross profit margin includes a royalty paid by the North American segment to our International segment based on production volume, which has the effect of lowering the North American segment's reported Gross profit margin, and increasing the International segment's reported Gross profit margin. Costs associated with Net sales are recorded in Cost of sales. Costs of sales includes the costs of receiving, producing, inspecting, warehousing, insuring, and shipping goods during the period, as

well as depreciation and amortization of long-lived assets used in these processes. The principal factors that impacted Gross profit margin during the year are identified and discussed below in the respective segment discussions.

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North America. North American Gross profit for the year ended December 31, 2011 increased to \$499.8 million from \$358.3 million for the same period in 2010, an increase of \$141.5 million, or 39.5%. The Gross profit margin in our North American segment was 49.7% and 46.4% for the year ended December 31, 2011 and 2010, respectively. Improvements in our North American Gross profit margin were primarily driven by our productivity programs, which generated improved efficiencies in manufacturing and distribution, favorable mix and fixed cost leverage related to higher volumes. These factors were partially offset by higher commodity costs and floor model discounts related to new product launches. Our North American Cost of sales increased to \$504.9 million for the year ended December 31, 2011 as compared to \$413.7 million for the year ended December 31, 2010, an increase of \$91.2 million, or 22.0%.

International. International Gross profit for the year ended December 31, 2011 increased to \$243.3 million from \$197.1 million for the same period in 2010, an increase of \$46.2 million, or 23.4%. The Gross profit margin in our International segment was 58.9% and 59.1% for the years ended December 31, 2011 and 2010, respectively. For the year ended December 31, 2011, the decrease in our International Gross profit margin was primarily driven by higher commodity costs and strategic investments, including an information technology upgrade at our manufacturing facility in Denmark during the third quarter of 2011 and floor model discounts related to new product launches. During the last six months of the year ended December 31, 2011, we experienced increased demand for our new products which, in combination with temporary productivity issues arising from the information technology upgrade, resulted in decreased inventory levels. As a result, we shipped product from North America thereby incurring incremental freight costs. These factors were partially offset by improved efficiencies in manufacturing, favorable mix and fixed cost leverage related to higher production volumes. Our International Cost of sales for the year ended December 31, 2011 increased to \$169.9 million, as compared to \$136.3 million for the year ended December 31, 2010, an increase of \$33.6 million, or 24.7%.

Selling and marketing expenses. Selling and marketing expenses include advertising and media production associated with our Direct channel, other marketing materials such as catalogs, brochures, videos, product samples, direct customer mailings and point of purchase materials, and sales force compensation. We also include in Selling and marketing expense certain new product development costs, including market research and new product testing. Selling and marketing expenses increased to \$276.9 million for the year ended December 31, 2011 as compared to \$199.7 million for the year ended December 31, 2010, an increase of \$77.1 million, or 38.6%. Selling and marketing expenses as a percentage of Net sales increased to 19.5% in 2011, compared to 18.1% for 2010. Our advertising expense for the year ended December 31, 2011 was \$148.8 million, or 10.5% of Net sales, compared to \$96.6 million, or 8.7%, for the same period in 2010, an increase of \$52.2 million, or 54.0%. Our objective is to align advertising expenses with our sales expectations. During 2011, consistent with our strategy, we made additional investments in advertising to increase brand awareness to drive future growth in certain key North American and International markets. All other selling and marketing expenses increased \$24.9 million, or 24.2%, which was driven by our increase in Net sales. All other selling and marketing expenses as a percentage of Net sales were approximately 9.0% and 9.3% for the years ended December 31, 2011 and 2010, respectively.

General, administrative and other expenses. General, administrative and other expenses include management salaries, information technology, professional fees, depreciation of furniture and fixtures, leasehold improvements and computer equipment, expenses for administrative functions, and research and development costs. General, administrative and other expenses as a percentage of Net sales was 8.9% for the year ended December 31, 2011 as compared to 9.9% for the same period in 2010. General, administrative and other expenses increased to \$125.7 million for the year ended December 31, 2011 as compared to \$109.8 million for the year ended December 31, 2010, an increase of \$15.9 million, or 14.5%. The increase in General, administrative and other expenses are primarily a result of increased salaries and associated expenses of \$11.1 million and fees associated with financing programs in our Direct sales channel of \$2.3 million, both of which were driven by our strong operating performance. In addition, incremental investments in information technology of \$4.8 million also contributed to this increase. The effects of these items have been partially offset by decreased legal and professional expenses of \$4.4 million, driven by costs

incurred in 2010 relating to the acquisition of our third party distributor in Canada and strategic research studies. Research and development expenses for the year ended December 31, 2011 were \$9.9 million compared to \$7.4 million for the same period in 2010, an increase of \$2.5 million, or 33.6%. Consistent with our strategy, we continue to invest in research and development in order to improve our existing product line and continue to introduce new and differentiated products.

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Interest expense, net. Interest expense, net includes the interest costs associated with our borrowings and the amortization of deferred financing costs related to those borrowings. Interest expense, net, decreased to \$11.9 million for the year ended December 31, 2011 as compared to \$14.5 million for the year ended December 31, 2010, a decrease of \$2.6 million, or 17.6%. The decrease in interest expense is primarily attributable to a decrease in the portion of the underlying debt subject to our interest rate swap, which expired on May 31, 2011, offset by an increase in debt outstanding. The interest rate on our variable rate debt was lower than the fixed rate of the interest rate swap.

On August 8, 2011, we entered into a new four-year interest rate swap agreement effective December 30, 2011 to manage interest costs and the risk associated with changing interest rates associated with a portion of the borrowings outstanding under our Senior Credit Facility. Under this swap, we pay at a fixed rate and receive payments at a variable rate. The swap effectively fixes the floating London Inter-bank Offering Rate (LIBOR) based interest rate to 1.25% on \$250.0 million of the outstanding balance as of December 31, 2011 under the Senior Credit Facility, with the outstanding balance subject to the swap expiring on December 30, 2015.

Income before income taxes. Income before income taxes for the year ended December 31, 2011 increased to \$328.4 million from \$230.9 million for the same period in 2010, an increase of \$97.5 million, or 42.2%. North America Income before income taxes for the year ended December 31, 2011 increased to \$224.6 million from \$137.7 million for the same period in 2010, an increase of \$86.9 million, or 63.1%. International Income before income taxes for the year ended December 31, 2011 increased to \$103.8 million from \$93.2 million for the same period in 2010, an increase of \$10.6 million, or 11.4%. The increase in income before income taxes was a result of the items discussed above.

Income tax provision. Income tax provision includes income taxes associated with taxes currently payable and deferred taxes, and includes the impact of net operating losses for certain of our foreign operations. Our effective tax rate was 33.1% and 31.9% for the years ended December 31, 2011 and 2010, respectively. The increase primarily relates to higher growth in the U.S. market versus other markets.



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Year Ended December 31, 2010 Compared with Year Ended December 31, 2009

A summary of Net sales, by channel and by segment, is set forth below:

| (in thousands) | CONSOLIDATED |            | NORTH AMERICA |            | INTERNATIONAL |            |
|----------------|--------------|------------|---------------|------------|---------------|------------|
|                | Year Ended   |            | Year Ended    |            | Year Ended    |            |
|                | December 31, |            | December 31,  |            | December 31,  |            |
|                | 2010         | 2009       | 2010          | 2009       | 2010          | 2009       |
| Retail         | \$ 953,191   | \$ 699,008 | \$ 694,725    | \$ 459,678 | \$ 258,466    | \$ 239,330 |
| Direct         | 73,687       | 52,763     | 59,668        | 43,283     | 14,019        | 9,480      |
| Healthcare     | 35,166       | 36,152     | 12,290        | 11,024     | 22,876        | 25,128     |
| Third party    | 43,377       | 43,233     | 5,343         | 11,339     | 38,034        | 31,894     |
|                | \$ 1,105,421 | \$ 831,156 | \$ 772,026    | \$ 525,324 | \$ 333,395    | \$ 305,832 |

A summary of Net sales, by product and by segment, is set forth below:

| (in thousands) | CONSOLIDATED |            | NORTH AMERICA |            | INTERNATIONAL |            |
|----------------|--------------|------------|---------------|------------|---------------|------------|
|                | Year Ended   |            | Year Ended    |            | Year Ended    |            |
|                | December 31, |            | December 31,  |            | December 31,  |            |
|                | 2010         | 2009       | 2010          | 2009       | 2010          | 2009       |
| Mattresses     | \$ 735,586   | \$ 549,937 | \$ 539,199    | \$ 366,925 | \$ 196,387    | \$ 183,012 |
| Pillows        | 130,564      | 107,539    | 65,728        | 48,814     | 64,836        | 58,725     |
| Other          | 239,271      | 173,680    | 167,099       | 109,585    | 72,172        | 64,095     |
|                | \$ 1,105,421 | \$ 831,156 | \$ 772,026    | \$ 525,324 | \$ 333,395    | \$ 305,832 |

Net sales. Net sales for the year ended December 31, 2010 increased to \$1.1 billion from \$831.2 million, an increase of \$274.3 million, or 33.0%. In 2009, our industry was affected by an unstable macroeconomic environment which had an adverse impact on our Net sales. However, during 2010, we experienced a significant improvement in Net sales. We believe our revenues gained momentum primarily as a result of investments made in marketing, research and development and new product introductions. We were well positioned to make these investments because we maintained our financial flexibility during the economic downturn. Consolidated Mattress sales increased \$185.6 million, or 33.8%, compared to the full year 2009. The increase in Mattress sales occurred primarily in our Retail channel with Net Sales increasing to \$953.2 million from \$699.0 million in the same period in 2009, an increase of \$254.1 million, or 36.3%. Consolidated Pillow sales increased approximately \$23.0 million, or 21.4% compared to the twelve months ended December 31, 2009. Consolidated Other, which includes adjustable bed bases, foundations and other related products, increased \$65.6 million, or 37.8%. Many of our Pillows and Other products are sold with mattress purchases. Therefore, when Mattress sales increase, Pillows and Other products are also impacted. The principal factors that impacted Net sales for each segment are discussed below, in the respective segment discussion.

North America. North American Net sales for the year ended December 31, 2010 increased to \$772.0 million from \$525.3 million for the same period in 2009, an increase of \$246.7 million, or 47.0%. Our North American Retail channel contributed \$694.7 million in Net sales for the twelve months ended December 31, 2010, for an increase of \$235.0 million, or 51.1%. The introduction of our new product line, the TEMPUR-Cloud® collection, was well received by retailers and consumers. This latest generation of proprietary TEMPUR® material was developed for consumers who want a soft sleep surface with the underlying support provided by a Tempur-Pedic mattress. During 2009, we launched the first product in the collection, the TEMPUR-Cloud Supreme®. In January 2010, we launched the second mattress in this line, the TEMPUR-Cloud®, and during the third quarter of 2010 we introduced the TEMPUR-Cloud Luxe®. The TEMPUR-Cloud® collection has been extremely successful, and by appealing to a different group of consumers, has greatly increased our target market and accordingly was a significant driver of our Net sales and market share growth in 2010. Additionally, we believe that our “Ask Me”™ advertising campaign has had a

positive impact on our performance. As a result, North American Mattress sales increased \$172.3 million, or 47.0%, over the same period in 2009, driven by the increase in our Retail channel. Net sales in the Direct channel increased by \$16.4 million, or 37.9%. We believe increased sales in the Direct channel are a result of our focus on building brand awareness and encouraging consumers to visit our website through our advertisements. The Third Party channel Net Sales decrease was attributable to our April 1, 2010 acquisition of our third-party distributor in Canada. Pillow sales increased \$16.9 million, or 34.6%, over the same period in 2009. Other Net sales increased \$57.5 million, or 52.5%, compared to the same period in 2009. Many of our Pillows and Other products are sold with mattress purchases. Therefore, when Mattress sales increase, Pillows and Other products are also impacted. Additionally, we have emphasized and experienced improved attach rates on adjustable bed bases which are sold at a higher price point than traditional foundations.

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International. International Net sales for the year ended December 31, 2010 increased to \$333.4 million from \$305.8 million for the same period in 2009, an increase of \$27.6 million, or 9.0%. On a constant currency basis, our International sales increased approximately 10.9%. We experienced some stabilization of the global economic slowdown in our international markets, which impacted Net sales in 2009. Additionally, we added new key customers in certain international markets. The International Retail channel increased \$19.1 million, or 8.0%, for the twelve months ended December 31, 2010. International Retail increased primarily because of growing our distribution and from the success of the Sensation mattress. Third party Net sales increased \$6.1 million, or 19.3%. The primary factor for the increase in Third party sales was related to improved macroeconomic environments in our significant Third party regions in our International segment. Our introduction of the Sensation mattress line in the International segment has been well accepted by retailers and consumers. As a result, International Mattress sales in 2010 increased \$13.4 million, or 7.3%, compared to 2009. Pillow sales in 2010 increased \$6.1 million, or 10.4%, as compared to 2009. Other product Net sales increased \$8.1 million, or 12.6%, as compared to 2009. Many of our Pillows and Other products are sold with mattress purchases. Therefore, when Mattress sales increase, Pillows and Other products are also impacted.

Gross profit. Gross profit for the year ended December 31, 2010 increased to \$555.4 million from \$393.7 million for the same period in 2009, an increase of \$161.7 million, or 41.1%. Gross profit margin for the year ended December 31, 2010 was 50.2%, as compared to 47.4% in the same period of 2009. Our Gross profit margin is impacted by, among other factors, geographic mix between segments. Additionally, our gross profit margin includes a royalty paid by the North American segment to our International segment based on production volume, which has the effect of lowering the North American segment's reported Gross profit margin, and increasing the International segment's reported Gross profit margin. The principal factors that impacted Gross profit margin during the year are identified and discussed below in the respective segment discussions.

North America. North American Gross profit for the year ended December 31, 2010 increased to \$358.3 million from \$222.6 million for the same period in 2009, an increase of \$135.7 million, or 61.0%. The Gross profit margin in our North American segment was 46.4% and 42.4% for the year ended December 31, 2010 and 2009, respectively. Improvements in our North American Gross profit margin were primarily driven by improved efficiencies in our manufacturing processes and fixed cost leverage related to higher volumes. These factors were partially offset by higher commodity costs. Our North American Cost of sales increased to \$413.7 million for the year ended December 31, 2010 as compared to \$302.8 million for the year ended December 31, 2009, an increase of \$111.0 million, or 36.7%.

International. International Gross profit for the year ended December 31, 2010 increased to \$197.1 million from \$171.2 million for the same period in 2009, an increase of \$26.0 million, or 15.2%. The Gross profit margin in our International segment was 59.1% and 56.0% for the years ended December 31, 2010 and 2009, respectively. For the year ended December 31, 2010, improvements in our International Gross profit margin were primarily driven by improved efficiencies in our manufacturing processes and fixed cost leverage related to higher volumes. These factors were partially offset by higher commodity costs. Our International Cost of sales for the year ended December 31, 2010 increased to \$136.3 million, as compared to \$134.7 million for the year ended December 31, 2009, an increase of \$1.6 million, or 1.2%.

Selling and marketing expenses. Selling and marketing expenses increased to \$199.7 million for the year ended December 31, 2010 as compared to \$153.4 million for the year ended December 31, 2009, an increase of \$46.3 million, or 30.2%. Selling and marketing expenses as a percentage of Net sales was relatively flat at 18.1% in 2010, compared to 18.5% for 2009. Our advertising expense for the year ended December 31, 2010 was \$96.6 million, or 8.7% of Net sales, compared to \$69.3 million, or 8.3%, for the same period in 2009, an increase of \$27.3 million. Our objective is to align advertising expenses with our sales expectations. During 2010, we made investments in advertising to drive future growth. For example, our marketing and advertising campaign "Ask Me,"™ which continued in

2010, focuses on increasing awareness of our products and the benefits they offer through word-of-mouth and social networking outlets. All other selling and marketing expenses increased \$19.0 million, or 22.6%, which was driven by our increase in Net sales. All other selling and marketing expenses as a percentage of Net sales were approximately 9.3% and 10.1% for the years ended December 31, 2010 and 2009, respectively.

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General, administrative and other expenses. General, administrative and other expenses as a percentage of Net sales was 9.9% for the year ended December 31, 2010 as compared to 11.5% for the same period in 2009. General, administrative and other expenses increased to \$109.8 million for the year ended December 31, 2010 as compared to \$95.4 million for the year ended December 31, 2009, an increase of \$14.4 million, or 15.1%. The increase in General, administrative and other expenses were primarily a result of an increase in salaries and associated expenses of \$6.3 million and fees associated with financing programs in our Direct sales channel of \$4.3 million, both of which were driven by our strong operating performance. In addition, an increase in professional fees related to strategic research studies of \$1.9 million and our ongoing investments in information technology of \$3.4 million also contributed to this increase. The effects of these items have been partially offset by a decrease in bad debt expense of \$5.4 million which reflects the improved condition of our receivables portfolio. Research and development expenses for the year ended December 31, 2010 were \$7.4 million compared to \$6.5 million for the same period in 2009. In 2010, we increased our investment in research and development in order to improve our existing product line and continue to introduce new and differentiated products.

Interest expense, net. Interest expense, net includes the interest costs associated with our borrowings and the amortization of deferred financing costs related to those borrowings. Interest expense, net, decreased to \$14.5 million for the year ended December 31, 2010 as compared to \$17.3 million for the year ended December 31, 2009, a decrease of \$2.8 million, or 16.4%. The decrease in interest expense is primarily attributable to a decrease in the portion of the underlying debt subject to our interest rate swap, offset by an increase in debt outstanding not subject to the interest rate swap. The interest rate on our variable rate debt was lower than the fixed rate of the interest rate swap.

Income before income taxes. Income before income taxes for the year ended December 31, 2010 increased to \$230.9 million from \$128.0 million for the same period in 2009, an increase of \$102.8 million, or 80.3%. North America income before income taxes for the year ended December 31, 2010 increased to \$137.7 million from \$49.7 million for the same period in 2009, an increase of \$88.0 million, or 177.0%. International income before income taxes for the year ended December 31, 2010 increased to \$93.2 million from \$78.3 million for the same period in 2009, an increase of \$14.8 million, or 18.9%. The increase in income before income taxes was a result of the items discussed above.

Income tax provision. Our effective tax rate was 31.9% and 33.6% for the years ended December 31, 2010 and 2009, respectively. The decrease primarily relates to increased benefit associated with certain manufacturing deductions allowable under U.S. law and the release of valuation allowances against deferred tax assets of certain foreign entities.

## Liquidity and Capital Resources

### Liquidity

Our principal sources of funds are cash flows from operations, borrowings made pursuant to the Senior Credit Facility and cash and cash equivalents on hand. Principal uses of funds consist of share repurchases made from time to time pursuant to share repurchase authorizations, payments of principal and interest on our Senior Credit Facility, acquisition of certain former third party distributors, capital expenditures and working capital. At December 31, 2011, we had working capital of \$196.3 million, including Cash and cash equivalents of \$111.4 million as compared to working capital of \$125.2 million including \$53.6 million in Cash and cash equivalents as of December 31, 2010. Working capital increased 56.7% for the year ended December 31, 2011 compared to the same period in 2010, primarily related to the growth in our business and cash and cash equivalents in our International segment.

Cash provided by operating activities increased \$64.6 million to \$248.7 million for the year ended December 31, 2011, as compared to \$184.1 million for the same period in 2010. The increase in cash provided by operating activities was due to an increase in Net income of \$62.5 million, increased amortization of stock-based compensation of \$5.1 million due to the February 2011 grant of performance-based restricted stock units, and an increase in change

in operating assets and liabilities of \$5.5 million, partially offset by a decrease in deferred taxes of \$13.5 million primarily due to the release of valuation allowances recorded against certain net operating losses. The net change in operating assets and liabilities are primarily driven by increased Accounts payable, partially offset by increased levels of Inventory and Accounts receivable, all of which increased to support our growth during 2011.

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Cash used in investing activities decreased to \$36.1 million for the year ended December 31, 2011 as compared to \$37.5 million for the year ended December 31, 2010, a decrease of \$1.4 million. The decrease primarily related to the April 2010 acquisition of our former third party distributor in Canada, partially offset by an increase in capital expenditures. In 2011, we made strategic investments, including an information technology upgrade, and capital projects that we believe create long-term operational efficiencies and support future growth.

Cash used by financing activities was \$148.9 million for the year ended December 31, 2011 as compared to \$106.4 million for the year ended December 31, 2010, representing an increase in cash used of \$42.5 million. This increase was primarily related to an increase in share repurchases during the year ended December 31, 2011 of \$115.9 million, partially offset by an increase in net borrowings of \$67.0 million and an increase in the amount of deductions taken on the Company's income tax returns for certain stock-based compensation awards exceeding cumulative compensation cost recognized on the financial statements due to increased stock options exercises and the Company's stock price.

## Capital Expenditures

Capital expenditures totaled \$29.5 million for the year ended December 31, 2011 and \$18.1 million for the year ended December 31, 2010. We currently expect our 2012 capital expenditures to be approximately \$50.0 million. This expected increase in capital expenditures in 2012 is attributable to continued strategic investments that we believe will support our plans for continued growth in future periods, including information technology upgrades and a new corporate headquarters in Lexington, Kentucky.

## Debt Service

Our long-term debt increased to \$585.0 million as of December 31, 2011 from \$407.0 million as of December 31, 2010. After giving effect to \$585.0 million in borrowings under the Senior Credit Facility and letters of credit outstanding of \$1.0 million, total availability under the Revolvers was \$184.0 million as of December 31, 2011. On June 28, 2011, the Company amended and restated its Senior Credit Facility, as amended, which increased the total availability under the facility to an aggregate of \$770.0 million, added an option to increase domestic availability by an additional \$250.0 million, extended the maturity date to June 28, 2016 and increased the applicable margins and certain fees to current market conditions.

As of December 31, 2011, we are in compliance with our debt covenants. The table below sets forth the calculation of our compliance with the Funded debt to Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) covenant. Both Funded debt and EBITDA are terms that are not recognized under U.S. GAAP and do not purport to be alternatives to Net income as a measure of operating performance or Total debt.

## Reconciliation of Net income to EBITDA

The following table sets forth the reconciliation of the Company's reported Net income to the calculation of EBITDA for the twelve months ended December 31, 2011:

|                  | Twelve Months<br>Ended<br>December 31,<br>2011 |
|------------------|--|
| (In thousands)   |  |
| GAAP Net income  | \$ 219,608                                     |
| Plus:            |  |
| Interest expense | 11,948   |
| Income taxes     | 108,783  |

|                             |    |         |
|-----------------------------|----|---------|
| Depreciation & amortization |    | 50,988  |
| EBITDA                      | \$ | 391,327 |



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## Reconciliation of Total debt to Funded debt

The following table sets forth the reconciliation of the Company's reported Total debt to the calculation of funded debt and funded debt to EBITDA ratio as of December 31, 2011:

| (In thousands)                | As of<br>December 31,<br>2011 |
|-------------------------------|-------------------------------|
| GAAP basis Total debt         | \$ 585,000                    |
| Plus:                         |                               |
| Letters of credit outstanding | 990                           |
| Funded debt                   | \$ 585,990                    |
| EBITDA                        | \$ 391,327                    |
| Funded debt to EBITDA         | 1.50 times                    |

The ratio of Funded debt to EBITDA was 1.50 times, within the covenant of our Senior Credit Facility, which requires this ratio not exceed 3.0 times.

We provide information regarding EBITDA and Funded debt which are not recognized terms under U.S. GAAP and do not purport to be alternatives to Net income as a measure of operating performance or Total debt. Because not all companies use identical calculations, these presentations may not be comparable to other similarly titled measures of other companies. A reconciliation of our Net income to EBITDA and a reconciliation of Total debt to Funded debt have been provided in this Management's Discussion and Analysis and we believe the use of these non-GAAP financial measures provide investors with additional useful information with respect to our Senior Credit Facility and our compliance with the related debt covenants.

## Stockholders' Equity

Share Repurchase Program. During 2011, we purchased 6.5 million shares of our common stock for a total cost of \$368.5 million pursuant to authorizations made by our Board of Directors. On January 23, 2012, our Board of Directors terminated the existing authority under the July 2011 authorization, as amended in October 2011, and approved a new share repurchase authorization of up to \$250.0 million of our 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 Senior Credit Facility. This share repurchase program may be limited, suspended or terminated at any time without notice.

## Future Liquidity Sources

Our primary sources of liquidity are cash flow from operations and borrowings under our Senior Credit Facility, which we amended and restated in 2011. We expect that ongoing requirements for debt service and capital expenditures will be funded from these sources. As of December 31, 2011, we had \$585.0 million in total Long-term debt outstanding, and our Stockholders' Equity was \$30.8 million. Our debt service obligations could, under certain circumstances, have material consequences to our security holders. Total cash interest payments related to our borrowings is expected to be approximately \$19.0 million in 2012. Interest expense in the periods presented also includes non-cash amortization of deferred financing costs.

Based upon the current level of operations and anticipated growth, we believe that cash generated from operations and amounts available under our Senior Credit Facility will be adequate to meet our anticipated debt service requirements,

capital expenditures, share repurchases, and working capital needs for the foreseeable future. There can be no assurance, however, that our business will generate sufficient cash flow from operations or that future borrowings will be available under facilities or otherwise enable us to service our indebtedness or to make anticipated capital expenditures.

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At December 31, 2011, total cash and cash equivalents was \$111.4 million, of which \$10.8 million was held in the U.S. and \$100.6 million was held by subsidiaries outside of the U.S. The amount of cash and cash equivalents held by subsidiaries outside of the U.S. and not readily convertible into other foreign currencies, including the U.S. Dollar, is not material to our overall liquidity or financial position. If these funds are needed for our U.S. operations, we may be required to accrue and pay U.S. taxes to repatriate these funds. Our intent is to permanently reinvest these funds outside of the U.S., with the possible exception of funds that have been previously subject to U.S. federal and state taxation. Our current plans do not demonstrate a need to repatriate cash held by our foreign subsidiaries in a taxable transaction to fund our U.S. operations. Our U.S. cash flows continue to be sufficient to fund our domestic operations and obligations, including investing and financing activities such as debt service and share repurchases.

## Contractual Obligations

Our contractual obligations and other commercial commitments as of December 31, 2011 are summarized below:

| Contractual Obligations (\$ in millions) | Payment Due By Period |         |         |         |          |        | After 2016 | Total Obligations (2) |
|--|-----------------------|---------|---------|---------|----------|--------|------------|-----------------------|
|  | 2012                  | 2013    | 2014    | 2015    | 2016     |        |            |                       |
| Long-term debt                           | \$ —                  | \$ —    | \$ —    | \$ —    | \$ 585.0 | \$ —   | \$ 585.0   |                       |
| Letters of credit                        | 0.5                   | 0.5     | —       | —       | —        | —      | 1.0        |                       |
| Interest payments (1)                    | 15.5                  | 15.5    | 14.6    | 14.6    | 12.5     | —      | 72.7       |                       |
| Operating leases                         | 7.3                   | 4.6     | 3.3     | 3.1     | 2.4      | 3.0    | 23.7       |                       |
| Capital expenditure commitments          | 15.7                  | —       | —       | —       | —        | —      | 15.7       |                       |
| Total                                    | \$ 39.0               | \$ 20.6 | \$ 17.9 | \$ 17.7 | \$ 599.9 | \$ 3.0 | \$ 698.1   |                       |

- (1) Represents interest payments under our debt agreements outstanding as of December 31, 2011, assuming debt outstanding as of the end of 2011 is not repaid until debt matures in June 2016. Interest payments are calculated based on LIBOR plus applicable margin in effect at December 31, 2011, after giving effect to the interest rate swap agreement that was entered into in August 2011. The interest rate swap converts a declining balance of our outstanding Senior Credit Facility from a variable rate to a fixed rate. The actual interest rates on the variable indebtedness incurred and the amount of our indebtedness could vary from those used to compute the above interest payment.
- (2) Excludes \$16.1 million related to accrued unrecognized tax benefits, relating to the Company's uncertain tax positions, including interest and penalties, as the period of payment cannot be reasonably estimated.

## Factors That May Affect Future Performance

**General Business and Economic Conditions.** Our business has been affected by general business and economic conditions, and these conditions could have an impact on future demand for our products. The U.S. macroeconomic environment was challenging in 2009 and was the primary factor in a slowdown in the mattress industry. In 2010, the U.S. macroeconomic environment improved slightly, but remained uncertain. In addition, our International segment has experienced weakening as a result of general business and economic conditions. In 2011, the global economic environment continued to be challenging, and we expect the uncertainty to remain in 2012.

In light of the macroeconomic environment, we took steps to further align our cost structure with our anticipated level of Net sales. In 2011, we continued to make strategic investments, including: maintaining focus on premium mattresses and pillows and introducing new products; investing in increasing our global brand awareness; extending our presence and improving our Retail account productivity and distribution; investing in our operating infrastructure to meet the requirements of our business; and taking actions to further strengthen our business.

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**Managing Growth.** Over the last few years, we have had to manage our business both through periods of rapid growth and economic uncertainty. Our Net sales increased from \$221.5 million in 2001 to \$1.1 billion in 2007 and decreased to \$927.8 million in 2008 and \$831.2 million in 2009. For the years ended December 31, 2010 and 2011, our Net sales increased to \$1.1 billion and \$1.4 billion, respectively. In the past, our growth has placed, and may continue to place, a strain on our management, production, product distribution network, information systems and other resources. In response to these types of challenges, management has continued to enhance operating and financial infrastructure, as appropriate. In addition, during 2007 through 2009, we had to manage a decline in sales as a result of the macroeconomic environment. During this period, we had to manage our cost structure to contain costs. Going forward, we expect our expenditures to enhance our operating and financial infrastructure, as well as expenditures for advertising and other marketing-related activities, will continue to be made as the continued growth in the business allows us the ability to make strategic investments. However, these expenditures may be limited by lower than planned sales or an inflationary cost environment.

**Gross Margins.** Our gross margin is primarily impacted by fixed cost leverage, the cost of raw materials, operational efficiency, product, channel and geographic mix, volume incentives offered to certain retail accounts and costs associated with new product introductions. We experienced increases in the price of certain raw materials during 2011. Future increases in raw material prices could have a negative impact on our gross margin if we do not raise prices to cover increased cost. Our gross margin can also be impacted by our operational efficiencies, including the particular levels of utilization at our three manufacturing facilities. We have made significant investments in our manufacturing infrastructure and have available manufacturing capacity. If we increase our Net sales significantly the effect of this operating leverage could have a significant positive impact on our gross margin. Our margins are also impacted by the growth in our Retail channel as sales in our Retail channel are at wholesale prices whereas sales in our Direct channel are at retail prices. Additionally, our overall product mix has shifted to mattresses and other products over the last several years, which has impacted our gross margins because mattresses generally carry lower margins than pillows and are sold with lower margin products such as adjustable bed bases and foundations. We expect our gross margins to be up for the full year 2012 through continued productivity programs and volume leverage, partially offset by increased commodity costs.

**Competition.** Participants in the mattress and pillow industries compete primarily on price, quality, brand name recognition, product availability, and product performance. We compete with a number of different types of mattress alternatives, including standard innerspring mattresses, other foam mattresses, waterbeds, futons, air beds and other air-supported mattresses. These alternative products are sold through a variety of channels, including furniture and bedding stores, department stores, mass merchants, wholesale clubs, telemarketing programs, television infomercials, television advertising and catalogs.

Our largest competitors have significant financial, marketing and manufacturing resources and strong brand name recognition, and sell their products through broad and well established distribution channels. Additionally, we believe that a number of our significant competitors offer mattress products claimed to be similar to our TEMPUR® mattresses and pillows. We provide strong channel profits to our retailers and distributors which management believes will continue to provide an attractive business model for our retailers and discourage them from carrying competing lower-priced products.

**Significant Growth Opportunities.** We believe there are significant opportunities to take market share from the innerspring mattress industry as well as other sleep surfaces. Our market share of the overall mattress industry is relatively small in terms of both dollars and units, which we believe provides us with a significant opportunity for growth. By broadening our brand awareness and offering superior sleep surfaces, we believe consumers will over time adopt our products at an increasing rate, which should expand our market share. We recently launched the TEMPUR-Simplicity™ collection in North America which broadens our addressable market within the premium category. The TEMPUR-Simplicity™ collection features three new mattresses that offer a solution for every sleep

preference. However, our business may be affected by general business and economic conditions that could have an impact on demand for our products.

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Additionally, by expanding distribution within our existing accounts, we believe we have the opportunity to grow our business. By extending our product line through our segmentation of products, we should be able to continue to expand the number of Tempur-Pedic® models offered at the retail store level, which should lead to increased sales. Based on this strategy we believe a focus on expanding distribution within our existing accounts and adding additional accounts, provides for continued growth opportunities and market share gains. However, our business may continue to be affected by general business and economic conditions that could have an impact on demand for our products, which could limit our market share and decrease sales. Our products are currently sold in approximately 7,900 furniture and bedding retail stores in the North American segment, out of a total of approximately 11,500 stores we have identified as appropriate targets. Within this addressable market, our plan is to increase our total penetration to a total of 9,000 to 10,000 over time. Our products are also sold in approximately 5,200 furniture retail and department stores in the International segment, out of a total of approximately 8,000 stores that we have identified as appropriate targets. We are continuing to develop products that are responsive to consumer demand in our markets internationally.

**Financial Leverage.** As of December 31, 2011, we had \$585.0 million of Long-term debt outstanding, and our Stockholders' Equity was \$30.8 million. Higher financial leverage makes us more vulnerable to general adverse competitive, economic and industry conditions. During 2011, we increased our total debt by \$178.0 million; however, our improved financial performance over this period has mitigated the impact of this increased debt on our leverage ratios. On June 28, 2011, we amended and restated our Senior Credit Facility which increased the total availability under the facility to an aggregate of \$770.0 million, added an option to increase domestic availability by an additional \$250.0 million, extended the maturity date to June 28, 2016, and increased the applicable margins and certain fees to current market conditions. There can be no assurance, however, that our business will generate sufficient cash flow from operations or that future borrowing will be available under our Senior Credit Facility. As of December 31, 2011, our ratio of funded debt to EBITDA was 1.50 times, within the covenant in our Senior Credit Facility, which requires this ratio not exceed 3.0 times. On August 8, 2011, we entered into a new four-year interest rate swap agreement to manage interest costs and the risk of changing interest rates associated with a portion of our borrowings outstanding under our Senior Credit Facility. See "ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Interest Rate Risk" under Part II of this report.

**Exchange Rates.** As a multinational company, we conduct our business in a wide variety of currencies and are therefore subject to market risk for changes in foreign exchange rates. We use foreign exchange forward contracts to manage a portion of the risk of the eventual net cash inflows and outflows resulting from foreign currency denominated transactions between Tempur-Pedic subsidiaries and their customers and suppliers, as well as between the Tempur-Pedic subsidiaries themselves. These hedging transactions may not succeed in effectively managing our foreign currency exchange rate risk. We typically do not apply hedge accounting to these contracts. See "ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Foreign Currency Exposures" under Part II of this report.

## Critical Accounting Policies and Estimates

Our management is responsible for our financial statements and has evaluated the accounting policies to be used in their preparation. Our management believes these policies are reasonable and appropriate. The following discussion identifies those accounting policies that we believe are critical in the preparation of our financial statements, the judgments and uncertainties affecting the application of those policies and the possibility that materially different amounts will be reported under different conditions or using different assumptions.

The preparation of financial statements in conformity with U.S. GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our actual results could differ from those estimates.

Revenue Recognition. Sales of product 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. We extend volume discounts to certain customers and reflect these amounts as a reduction of Net sales.



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Our estimates of sales returns are a critical component of our revenue recognition. We recognize sales, net of estimated returns, when we ship our products to customers and the risks and rewards of ownership are transferred to them. Estimated sales returns are provided at the time of sale, based on our level of historical sales returns. We allow returns for up to 120 days following a sale, depending on the channel and promotion. Our level of sales returns differs by channel, with our Direct channel typically experiencing the highest rate of returns. Our level of returns has been consistent with our estimates and has been improving steadily over the last year as our Retail channel, which experiences lower returns than other sales channels, continues to grow as a percentage of overall Net sales.

We do not recognize revenue unless collectability is reasonably assured at the time of sale. We extend credit based on the creditworthiness of our customers, and generally no collateral is required at the time of sale. Our allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We regularly review the adequacy of our allowance for doubtful accounts. We determine the allowance based on historical write-off experience and current economic conditions and also consider 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. Historically, less than 1% of Net sales ultimately prove to be uncollectible. 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.

**Warranties.** Cost of sales includes estimated costs to service warranty claims of our customers. Our estimate is based on our historical claims experience and extensive product testing that we perform from time to time. We provide a 20-year warranty for sales in the North American segment and a 15-year warranty for International segment sales on mattresses, each prorated for the last 10 years. Because the majority of our products have not been in use by our customers for the full warranty period, we rely on the combination of historical experience and product testing for the development of our estimate for warranty claims. Our estimate of warranty claims could be adversely affected if our historical experience differs materially from the performance of the product in our product testing. We also provide 2-year to 3-year warranties on pillows. Estimated future obligations related to these products are provided by charges to operations in the period in which the related revenue is recognized.

**Long-Lived Assets.** The cost of plant and equipment is depreciated by the straight-line method over the estimated useful lives of the assets. Useful lives are based on historical experience and are adjusted when changes in planned use, technological advances or other factors show that a different life would be more appropriate. Such costs are periodically reviewed for recoverability when impairment indicators are present. Such indicators include, among other factors, operating losses, unused capacity, market value declines and technological obsolescence. Recorded values of property, plant and equipment that are not expected to be recovered through undiscounted future net cash flows are written down to current fair value, which generally is determined from estimated discounted future net cash flows (assets held for use) or net realizable value (assets held for sale).

Goodwill and intangible assets with indefinite lives are subject to an annual impairment test as of October 1 and whenever events or circumstances make it more likely than not that impairment may have occurred. Such tests are completed separately with respect to the goodwill of each of our reportable business segments. Because market prices of our reporting units are not readily available, we make various estimates and assumptions in determining the estimated fair values of those units. Fair value is based on an income approach, with an appropriate risk adjusted discount rate, and a market approach. Significant assumptions inherent in the methodologies are employed and include such estimates as discount rates, growth rates and the selection of peer company multiples. The use of alternative estimates or adjusting the discount rate could affect the estimated fair value of the assets and potentially result in impairment.

We have determined that our reporting units for allocation of goodwill are our North American and International operating segments. The most recent annual impairment tests indicated that the fair values of each of our reporting

units and trade name (which has an indefinite life) were substantially in excess of their carrying values. Despite that excess, however, impairment charges could still be required if a divestiture decision were made or other significant economic event were made or occurred with respect to one of our reporting units. Subsequent to our October 1 annual impairment test, no indications of an impairment were identified.

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Income Taxes. Accounting for income taxes requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities. These deferred taxes are measured by applying the provisions of tax laws in effect at the balance sheet date.

We recognize deferred tax assets in our Consolidated Balance Sheets, and these deferred tax assets typically represent items deducted currently from operating income in the financial statements that will be deducted in future periods in tax returns. A valuation allowance is recorded against certain deferred tax assets to reduce the consolidated deferred tax asset to an amount that will, more likely than not, be realized in future periods. The valuation allowance is based, in part, on our estimate of future taxable income, the expected utilization of foreign tax loss carryforwards, and the expiration dates of such tax loss carryforwards. Significant assumptions are used in developing the analysis of future taxable income for purposes of determining the valuation allowance for deferred tax assets which, in our opinion, are reasonable under the circumstances. At December 31, 2011, we have provided valuation allowances for substantially all subsidiaries in a cumulative three year loss position.

Our consolidated effective tax rate and related tax reserves are subject to uncertainties in the application of complex tax regulations from numerous tax jurisdictions around the world. We recognize liabilities for anticipated taxes in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, taxes are and could be due. This liability is estimated based on a prescribed recognition threshold and measurement attributes for the financial statement recognition and measurements of a tax position taken or expected to be taken in a tax return. The resolution of tax matters for an amount that is different than the amount reserved would be recognized in our effective tax rate during the period in which such resolution occurs.

### Impact of Recently Issued Accounting Pronouncements

See “ITEM 8. Financial Statements and Supplementary Data - Note 2 of the Notes to Consolidated Financial Statements” in Part II of this report for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Foreign Currency Exposures

Our earnings, as a result of our global operating and financing activities, are exposed to changes in foreign currency exchange rates, which may adversely affect our results of operations and financial position. Our outlook for 2012 assumes modest unfavorable currency exchange rates versus the year ended December 31, 2011. Should currency rates change sharply, our results could be impacted.

We protect a portion of our currency exchange exposure with foreign currency forward contracts. A sensitivity analysis indicates the potential loss in fair value on foreign currency forward contracts outstanding at December 31, 2011, resulting from a hypothetical 10% adverse change in all foreign currency exchange rates against the U.S. dollar, is approximately \$0.1 million. Such losses would be largely offset by gains from the revaluation or settlement of the underlying assets and liabilities that are being protected by the foreign currency forward contracts.

We do not apply hedge accounting to the foreign currency forward contracts used to offset currency-related changes in the fair value of foreign currency denominated assets and liabilities. These contracts are marked-to-market through earnings at the same time that the exposed assets and liabilities are remeasured through earnings.



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### Interest Rate Risk

We are exposed to changes in interest rates. Our Senior Credit Facility has a variable rate. On August 8, 2011, we entered into a new four-year interest rate swap agreement to manage interest costs and the risk of changing interest rates associated with a portion of the borrowings outstanding under our Senior Credit Facility. Under this swap, we pay at a fixed rate and receive payments at a variable rate. The swap effectively fixes the floating LIBOR-based interest rate to 1.25% on \$250.0 million of the outstanding balance as of December 31, 2011 under our Senior Credit Facility, with the outstanding balance declining over time. The interest rate swap expires on December 30, 2015. The Company will select the LIBOR-based rate on the hedged portion of our Senior Credit Facility during the term of the swap. The effective portion of the change in value of the swap is reflected as a component of comprehensive income and recognized as Interest expense, net as payments are paid or accrued. The remaining gain or loss in excess of the cumulative change in the present value of the future cash flows of the hedged item, if any (i.e., the ineffective portion) or hedge components excluded from the assessment of effectiveness are recognized as Interest expense, net during the current period.

Interest rate changes generally do not affect the market value of such debt but do impact the amount of our interest payments and therefore, our future earnings and cash flows, assuming other factors are held constant. On December 31, 2011, after giving effect to our interest rate swap agreement, we had variable-rate debt of approximately \$335.0 million. Holding other variables constant, including levels of indebtedness, a one hundred basis point increase in interest rates on our variable-rate debt would cause an estimated reduction in income before income taxes for the next year of approximately \$3.4 million.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements required by this item are included in Part IV, ITEM 15 of this report and are presented beginning on page 46.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

### ITEM 9A. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal financial officer), of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act), as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of December 31, 2011, and designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

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Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on our assessment and those criteria, management believes that we maintained effective internal control over financial reporting as of December 31, 2011.

Our independent registered public accounting firm, Ernst & Young LLP, has issued a report on the Company's internal control over financial reporting as of December 31, 2011. That report appears on page 44 of this report.

Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Tempur-Pedic International Inc. and Subsidiaries

We have audited Tempur-Pedic International Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Tempur-Pedic International Inc. and Subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting." Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Tempur-Pedic International Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Tempur-Pedic International Inc. and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011 and our reported dated January 30, 2012, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Louisville, Kentucky  
January 30, 2012





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ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference from our definitive proxy statement for the 2012 Annual Meeting of Stockholders (the Proxy Statement) under the sections entitled “Proposal One—Election of Directors,” and “Board of Directors’ Meetings, Committees of the Board and Related Matters—Corporate Governance,” — “Committees of the Board,” — “Policies Governing Director Nominations,” and “Executive Compensation and Related Information—Section 16(a) Beneficial Ownership Reporting Compliance.”

Information relating to executive officers is set forth in Part I of this report following ITEM 1 under the caption “Executive Officers of the Registrant.”

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from the Proxy Statement under the sections entitled “Executive Compensation and Related Information” and “Board of Directors’ Meetings, Committees of the Board and Related Matters—Compensation Committee Interlocks and Insider Participation.”

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

For information required by S-K 201(d) see “Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities—Equity Compensation Plan Information” under Part II of this report.

All other information required by this Item is incorporated by reference from the Proxy Statement under the section entitled “Principal Security Ownership and Certain Beneficial Owners.”

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from the Proxy Statement under the section entitled “Executive Compensation and Related Information—Certain Relationships and Related Transactions” and “Board of Directors’ Meetings, Committees of the Board and Related matters—Directors’ Independence.”

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated by reference from the Proxy Statement under the sections entitled “Proposal Two— Ratification of Independent Auditors—Fees for Independent Auditors During Fiscal Year Ended December 31, 2011” and “—Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services of Independent Auditor.”



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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)

1. Financial statements:

Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

Consolidated Statements of Income for the years ended December 31, 2011, 2010 and 2009

Consolidated Balance Sheets as of December 31, 2011 and 2010

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2011, 2010 and 2009

Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009

Notes to Consolidated Financial Statements

2. Financial Statement Schedule:

Schedule II—Valuation of Qualifying Accounts and Reserves

All other schedules have been omitted because they are inapplicable, not required, or the information is included elsewhere in the consolidated financial statements or notes thereto.

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3. Exhibits:

The following is an index of the exhibits included in this report or incorporated herein by reference.

EXHIBIT INDEX

- 3.1 Amended and Restated Certificate of Incorporation of Tempur-Pedic International Inc. (filed as Exhibit 3.1 to Amendment No. 3 to the Registrant's registration statement on Form S-1 (File No. 333-109798) as filed on December 12, 2003). (1)
- 3.2 Fourth Amended and Restated By-laws of Tempur-Pedic International Inc. (filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K as filed on March 11, 2010). (1)
- 4.1 Specimen certificate for shares of common stock (filed as Exhibit 4.1 to Amendment No. 3 to the Registrant's registration statement on Form S-1 (File No. 333-109798) as filed on December 12, 2003). (1)
- 10.1 Amended and Restated Credit Agreement, dated as of June 28, 2011 among Tempur-Pedic Management, Inc., Dan-Foam ApS, as Borrowers; Tempur-Pedic International Inc., Tempur World, LLC, and Certain Subsidiaries and Affiliates of the Borrowers as Guarantors; Bank of America, N.A., as Domestic Administrative Agent and Domestic Collateral Agent; Nordea Bank Danmark A/S, as Foreign Administrative Agent, European Co-Agent and Foreign Collateral Agent; Fifth Third Bank and JPMorgan Chase Bank, N.A. as U.S. Co-Agents; Wells Fargo Bank National Association, as Syndication Agent; Merrill Lynch, Piece, Fenner & Smith Incorporated and Wells Fargo Securities, LLC, as Joint Lead Arrangers and Joint Book Managers (filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed on June 29, 2011). (1)
- 10.2 Bond Purchase Agreement, dated October 26, 2005, by and among Tempur World LLC, Tempur Production USA, Inc. and Bernalillo County (filed as Exhibit 10.5 to the Registrant's Annual Report on Form 10-K as filed on March 14, 2006). (1)
- 10.3 Trust Indenture, dated September 1, 2005, by and between Bernalillo County and The Bank of New York Trust Company, N.A., as Trustee (filed as Exhibit 10.2 to the Registrant's Annual Report on Form 10-K as filed on March 14, 2006). (1)
- 10.4 Mortgage, Assignment, Security Agreement and Fixture Filing, dated as of October 27, 2005, by and between Bernalillo County and Tempur Production USA, Inc. (filed as Exhibit 10.7 to the Registrant's Annual Report on Form 10-K as filed on March 14, 2006). (1)
- 10.5 Lease Agreement, dated September 1, 2005, by and between Bernalillo County and Tempur Production USA, Inc. (filed as Exhibit 10.3 to the Registrant's Annual Report on Form 10-K as filed on March 14, 2006). (1)
- 10.6 Non-Employee Director Deferred Compensation Plan (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q as filed on July 28, 2010). (1) (2)
- 10.7 Tempur-Pedic International Inc. 2002 Stock Option Plan (filed as Exhibit 10.5 to the Registrant's registration statement on Form S-4 (File No. 333-109054-02) as filed on September 23, 2003). (1) (2)
- 10.8 Amended and Restated Tempur-Pedic International Inc. 2003 Equity Incentive Plan (filed as Appendix a to the Registrant's Definitive Proxy Statement on Schedule 14A (File No. 001-31922) as filed on March 24, 2008). (1) (2)
- 10.9 First Amendment to the Amended and Restated 2003 Equity Incentive Plan (filed as Appendix A to the Registrant's Registration Proxy Statement on Schedule 14A (File No. 001-31922) as filed on March 25, 2009). (1)(2)
- 10.10 Tempur-Pedic International Inc. Long-term Incentive Plan (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q as filed on April 27, 2010). (1) (2)
- 10.11 Amended and Restated Annual Incentive Bonus Plan for Senior Executives (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q as filed on April 27, 2010). (1) (2)
- 10.12 Tempur-Pedic International Inc. 2003 Employee Stock Purchase Plan (filed as Exhibit No. 10.18 to Amendment No. 3 to the Registrant's registration statement on Form S-1 (File No. 333-109798) filed with the Commission on December 12, 2003). (1) (2)

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- 10.13 Employment and Noncompetition Agreement dated as June 30, 2008, between Tempur-Pedic International Inc. and Mark Sarvary (filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed on June 30, 2008). (1)(2)
- 10.14 Employment Agreement dated as of July 18, 2006 between Tempur-Pedic International Inc. and Richard Anderson (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q as filed November 7, 2006). (1)(2)
- 10.15 Employment and Noncompetition Agreement dated as of December 1, 2004, between Tempur-Pedic International Inc. and Matthew D. Clift (filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K as filed on December 2, 2004). (1)(2)
- 10.16 Employment and Non-Competition Agreement by and between Tempur-Pedic International Inc. and Lou Hedrick Jones dated as of June 1, 2009) (filed as Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q as filed on July 27, 2009). (1)(2)
- 10.17 Employment Agreement dated September 12, 2003, between Tempur International Limited and David Montgomery (filed as Exhibit 10.13 to Amendment No. 1 to the Registrant's registration statement on Form S-4 ((File No. 333-109054-02) as filed on October 31, 2003). (1)(2)
- 10.18 Employment and Non-Competition Agreement by and between Tempur-Pedic International Inc. and Brad Patrick dated as of September 1, 2010) (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q as filed on October 28, 2010). (1)(2)
- 10.19 Amended and Restated Employment Agreement dated March 5, 2008 by and among Tempur-Pedic International Inc., Tempur World, LLC and Dale E. Williams (filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K as filed March 7, 2008). (1)(2)
- 10.20 Form of Stock Option Agreement under the 2003 Equity Incentive Plan (filed as Exhibit 10.9 to Registrant's Quarterly Report on Form 10-Q as filed August 8, 2006). (1)(2)
- 10.21 Form of Stock Option Agreement under the Amended and Restated 2003 Equity Incentive Plan (EVP) (filed as Exhibit 9.1 to Registrant's Current Report on Form 8-K as filed on May 19, 2008). (1)(2)
- 10.22 Form of Stock Option Agreement under the Amended and Restated 2003 Equity Incentive Plan (Director) (filed as Exhibit 10.40 to Registrant's Annual Report on Form 10-K as filed on February 12, 2009). (1)(2)
- 10.23 Form of Stock Option Agreement under the United Kingdom Approved Share Option Sub Plan to the 2003 Equity Incentive Plan (filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q as filed on April 30, 2009). (1)(2)
- 10.24 Form of Stock Option Agreement under the Amended and Restated 2003 Equity Incentive Plan (Director) (filed as Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q as filed on July 28, 2010). (1)(2)
- 10.25 Stock Option Agreement dated as of March 12, 2004 between Tempur-Pedic International Inc. and Nancy F. Koehn (filed as Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q as filed on May 17, 2004). (1)(2)
- 10.26 Option Agreement dated as of December 1, 2004 between Tempur-Pedic International Inc. and Matthew D. Clift (filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K as filed on December 2, 2004). (1)(2)
- 10.27 Stock Option Agreement dated as of February 23, 2006 between Tempur-Pedic International Inc. and Matthew D. Clift (filed as Exhibit 10.33 to Registrant's Annual Report on Form 10-K as filed on February 28, 2007). (1)(2)
- 10.28 Stock Option Agreement dated as of February 23, 2006 between Tempur-Pedic International Inc. and Sir Paul Judge (filed as Exhibit 10.34 to Registrant's Annual Report on Form 10-K as filed on February 28, 2007). (1)(2)
- 10.29 Stock Option Agreement dated as of February 23, 2006 between Tempur-Pedic International Inc. and Nancy F. Koehn (filed as Exhibit 10.35 to Registrant's Annual Report on Form 10-K as filed on February 28, 2007). (1)(2)
- 10.30 Stock Option Agreement dated June 28, 2006 between Tempur-Pedic International Inc. and David Montgomery (filed as Exhibit 10.7 to Registrant's Quarterly Report on Form 10-Q as filed August 8, 2006). (1)(2)
- 10.31 Stock Option Agreement dated June 28, 2006 between Tempur-Pedic International Inc. and Dale E. Williams (filed as Exhibit 10.8 to Registrant's Quarterly Report on Form 10-Q as filed August 8, 2006). (1)(2)
- 10.32 Stock Option Agreement dated February 5, 2008 between Tempur-Pedic International, Inc. and Richard Anderson (filed as Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q as filed on May 6, 2008). (1)(2)

- 10.33 Stock Option Agreement dated June 30, 2008 between Tempur-Pedic International Inc. and Mark Sarvary (filed as Exhibit 10.2 to Registrant's Current Report on Form 8-K as filed on June 30, 2008). (1) (2)
- 21.1 Subsidiaries of Tempur-Pedic International Inc.
- 23.1 Consent of Ernst & Young LLP.
- 31.1 Certification of Chief Executive Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (3)
- 101 The following materials from Tempur-Pedic International Inc.'s Annual Report on Form 10-K for the year ended December 31, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Income, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows, and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text.

(1) Incorporated by reference.

(2) Indicates management contract or compensatory plan or arrangement.

(3) This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, nor shall it be deemed incorporated by reference in any filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TEMPUR-PEDIC INTERNATIONAL INC.  
(Registrant)

January 30, 2012

By: /s/ MARK SARVARY  
Mark Sarvary  
President and Chief Executive Officer



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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on the 30th of January, 2012, on behalf of the registrant and in the capacities indicated.

| Signature  | Capacity  |
|--|---|
| /S/ MARK SARVARY<br>Mark Sarvary                       | President, Chief Executive Officer (Principal Executive Officer) and Director             |
| /S/ DALE E. WILLIAMS<br>Dale E. Williams               | Executive Vice President and Chief Financial Officer (Principal Financial Officer)        |
| /S/ BHASKAR RAO<br>Bhaskar Rao                         | Chief Accounting Officer and Senior Vice President Finance (Principal Accounting Officer) |
| /S/ FRANCIS A. DOYLE<br>Francis A. Doyle               | Director  |
| /S/ EVELYN S. DILSAVER<br>Evelyn S. Dilsaver           | Director  |
| /S/ PETER K. HOFFMAN<br>Peter K. Hoffman               | Director  |
| /S/ JOHN A. HEIL<br>John A. Heil                       | Director  |
| /S/ NANCY F. KOEHN<br>Nancy F. Koehn                   | Director  |
| /S/ SIR PAUL JUDGE<br>Sir Paul Judge                   | Director  |
| /S/ CHRISTOPHER A. MASTO<br>Christopher A. Masto       | Director  |
| /S/ P. ANDREWS MCLANE<br>P. Andrews McLane             | Director  |
| /S/ ROBERT B. TRUSSELL, JR.<br>Robert B. Trussell, Jr. | Director  |



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INDEX TO HISTORICAL FINANCIAL STATEMENTS

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| <u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>   | F-4 |
| <u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2011, 2010 and 2009</u> | F-5 |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Tempur-Pedic International Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Tempur-Pedic International Inc. and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tempur-Pedic International Inc. and Subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Tempur-Pedic International Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 30, 2012, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Louisville, Kentucky  
January 30, 2012

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(In thousands, except per common share amounts)

|   | Year Ended December 31, |              |            |
|---|-------------------------|--------------|------------|
|   | 2011                    | 2010         | 2009       |
| Net sales                                   | \$ 1,417,938            | \$ 1,105,421 | \$ 831,156 |
| Cost of sales                               | 674,848                 | 549,994      | 437,414    |
| Gross profit                                | 743,090                 | 555,427      | 393,742    |
| Selling and marketing expenses              | 276,870                 | 199,722      | 153,440    |
| General, administrative and other expenses  | 125,689                 | 109,803      | 95,357     |
| Operating income                            | 340,531                 | 245,902      | 144,945    |
| Other expense, net:                         |                         |              |            |
| Interest expense, net                       | (11,948)                | (14,501)     | (17,349)   |
| Other (expense) income, net                 | (192)                   | (536)        | 441        |
| Total other expense                         | (12,140)                | (15,037)     | (16,908)   |
| Income before income taxes                  | 328,391                 | 230,865      | 128,037    |
| Income tax provision                        | 108,783                 | 73,720       | 43,044     |
| Net income                                  | \$ 219,608              | \$ 157,145   | \$ 84,993  |
| Earnings per common share:                  |                         |              |            |
| Basic                                       | \$ 3.27                 | \$ 2.23      | \$ 1.13    |
| Diluted                                     | \$ 3.18                 | \$ 2.16      | \$ 1.12    |
| Weighted average common shares outstanding: |                         |              |            |
| Basic                                       | 67,070                  | 70,348       | 74,934     |
| Diluted                                     | 69,149                  | 72,792       | 76,048     |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands)

|  | December 31,<br>2011 | 2010       |
|--|----------------------|------------|
| <b>ASSETS</b>  |                      |            |
| Current Assets:  |                      |            |
| Cash and cash equivalents  | \$ 111,367           | \$ 53,623  |
| Accounts receivable, net   | 142,412              | 115,630    |
| Inventories  | 91,212               | 69,856     |
| Prepaid expenses and other current assets  | 20,088               | 18,646     |
| Deferred income taxes  | 14,391               | 13,725     |
| Total Current Assets   | 379,470              | 271,480    |
| Property, plant and equipment, net   | 160,502              | 159,807    |
| Goodwill   | 213,273              | 212,468    |
| Other intangible assets, net   | 66,491               | 68,745     |
| Other non-current assets   | 8,904                | 3,503      |
| Total Assets   | \$ 828,640           | \$ 716,003 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                      |            |
| Current Liabilities:   |                      |            |
| Accounts payable   | \$ 69,936            | \$ 48,288  |
| Accrued expenses and other current liabilities   | 92,737               | 85,469     |
| Income taxes payable   | 20,506               | 12,477     |
| Total Current Liabilities  | 183,179              | 146,234    |
| Long-term debt   | 585,000              | 407,000    |
| Deferred income taxes  | 24,227               | 32,315     |
| Other non-current liabilities  | 5,443                | 4,421      |
| Total Liabilities  | 797,849              | 589,970    |
| Commitments and Contingencies (see Note 10)  |                      |            |
| Stockholders' Equity:  |                      |            |
| Common stock, \$0.01 par value, 300,000 shares authorized; 99,215 shares issued as of December 31, 2011 and 2010 | 992                  | 992        |
| Additional paid in capital   | 361,807              | 320,952    |
| Retained earnings  | 742,480              | 522,872    |
| Accumulated other comprehensive loss   | (14,686)             | (6,188)    |
| Treasury stock, at cost; 35,445 and 30,731 shares as of December 31, 2011 and 2010, respectively                 | (1,059,802)          | (712,595)  |
| Total Stockholders' Equity   | 30,791               | 126,033    |
| Total Liabilities and Stockholders' Equity   | \$ 828,640           | \$ 716,003 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(In thousands)

|   | Common Shares    |        | Treasury Shares  |               | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total      |
|---|------------------|--------|------------------|---------------|----------------------------------|----------------------|---|------------|
|   | Shares<br>Issued | At Par | Shares<br>Issued | At Cost       |                                  |                      |   |            |
| Balance,<br>December 31,<br>2008  | 99,215           | \$ 992 | 24,382           | \$ (488,399 ) | \$ 291,018                       | \$ 281,422           | \$ (12,590 )                                  | \$ 72,443  |
| Comprehensive<br>Income:  |                  |        |                  |               |                                  |                      |   |            |
| Net income  |                  |        |                  |               |                                  | 84,993               |   | 84,993     |
| Derivative<br>instruments<br>accounted for<br>as hedges, net<br>of tax of \$1,851 |                  |        |                  |               |                                  |                      | 2,895   | 2,895      |
| Foreign<br>currency<br>adjustments  |                  |        |                  |               |                                  |                      | 1,691   | 1,691      |
| Total<br>Comprehensive<br>Income  |                  |        |                  |               |                                  | 84,993               | 4,586   | 89,579     |
| Exercise of stock<br>options  |                  |        | (279)            | 3,135         | 6                                | (688 )               |   | 2,453      |
| Tax adjustments<br>related to stock<br>compensation(1)                            |                  |        |                  |               | (841 )                           |                      |   | (841 )     |
| Amortization of<br>unearned<br>stock-based<br>compensation                        |                  |        |                  |               | 8,659                            |                      |   | 8,659      |
| Balance,<br>December 31,<br>2009  | 99,215           | \$ 992 | 24,103           | \$ (485,264 ) | \$ 298,842                       | \$ 365,727           | \$ (8,004 )                                   | \$ 172,293 |
| Comprehensive<br>Income:  |                  |        |                  |               |                                  |                      |   |            |
| Net income  |                  |        |                  |               |                                  | 157,145              |   | 157,145    |
| Derivative<br>instruments<br>accounted for<br>as hedges, net<br>of tax of \$2,120 |                  |        |                  |               |                                  |                      | 3,315   | 3,315      |
| Foreign<br>currency   |                  |        |                  |               |                                  |                      | (1,499 )                                      | (1,499 )   |



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|   |        |        |         |                |            |            |              |            |           |         |
|---|--------|--------|---------|----------------|------------|------------|--------------|------------|-----------|---------|
| adjustments   |        |        |         |                |            |            |              |            |           |         |
| Total   |        |        |         |                |            |            |              |            |           |         |
| Comprehensive Income  |        |        |         |                |            | 157,145    | 1,816        |            | 158,961   |         |
| Purchase of noncontrolling interest                                   |        |        |         |                |            | (1,463 )   |              |            | (1,463 )  |         |
| Exercise of stock options   |        |        | (1,872) | 22,669         |            | 6,390      |              |            | 29,059    |         |
| Tax adjustments related to stock compensation                         |        |        |         |                |            | 5,590      |              |            | 5,590     |         |
| Treasury Stock repurchase   |        |        | 8,500   | (250,000 )     |            |            |              |            | (250,000) |         |
| Amortization of unearned stock-based compensation                     |        |        |         |                |            | 11,593     |              |            | 11,593    |         |
| Balance, December 31, 2010  | 99,215 | \$ 992 | 30,731  | \$ (712,595 )  | \$ 320,952 | \$ 522,872 | \$ (6,188 )  | \$ 126,033 |           |         |
| Comprehensive Income:   |        |        |         |                |            |            |              |            |           |         |
| Net income  |        |        |         |                |            |            | 219,608      |            | 219,608   |         |
| Derivative instruments accounted for as hedges, net of tax of \$(463) |        |        |         |                |            |            |              | (724 )     | (724 )    |         |
| Foreign currency adjustments  |        |        |         |                |            |            |              | (7,774 )   | (7,774 )  |         |
| Total   |        |        |         |                |            |            |              |            |           |         |
| Comprehensive Income  |        |        |         |                |            |            |              | 219,608    | (8,498 )  | 211,110 |
| Exercise of stock options   |        |        | (1,797) | 21,286         |            | 4,970      |              |            | 26,256    |         |
| Tax adjustments related to stock compensation                         |        |        |         |                |            | 19,192     |              |            | 19,192    |         |
| Treasury Stock repurchase   |        |        | 6,511   | (368,493 )     |            |            |              |            | (368,493) |         |
| Amortization of unearned stock-based compensation                     |        |        |         |                |            | 16,693     |              |            | 16,693    |         |
| Balance, December 31, 2011  | 99,215 | \$ 992 | 35,445  | \$ (1,059,802) | \$ 361,807 | \$ 742,480 | \$ (14,686 ) | \$ 30,791  |           |         |

(1) Includes \$359 of Excess tax benefit from stock based compensation.

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

|   | Year Ended December 31, |            |           |
|---|-------------------------|------------|-----------|
|   | 2011                    | 2010       | 2009      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                         |            |           |
| Net income  | \$ 219,608              | \$ 157,145 | \$ 84,993 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |            |           |
| Depreciation and amortization   | 34,295                  | 32,361     | 31,424    |
| Amortization of stock-based compensation  | 16,693                  | 11,608     | 8,789     |
| Amortization of deferred financing costs  | 1,034                   | 690        | 692       |
| Bad debt expense  | 1,563                   | 531        | 5,936     |
| Deferred income taxes   | (8,528)                 | 4,946      | (7,276)   |
| Foreign currency adjustments  | 1,194                   | (1,666)    | (115)     |
| Loss on disposal of equipment   | 54                      | 1,201      | 564       |
| Changes in operating assets and liabilities, net of effects of acquired business: |                         |            |           |
| Accounts receivable   | (30,198)                | (12,752)   | (10,542)  |
| Inventories   | (18,473)                | (6,710)    | 3,738     |
| Prepaid expenses and other current assets   | (2,772)                 | (6,519)    | (4,418)   |
| Accounts payable  | 21,675                  | (1,145)    | 7,808     |
| Accrued expenses and other  | 3,867                   | (370)      | 14,044    |
| Income taxes payable  | 8,694                   | 4,802      | (651)     |
| Net cash provided by operating activities   | 248,706                 | 184,122    | 134,986   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                         |            |           |
| Acquisition of trademarks and other   | (2,044)                 | (684)      | —         |
| Acquisition of businesses, net of cash acquired                                   | (4,566)                 | (18,692)   | —         |
| Purchases of property, plant and equipment  | (29,466)                | (18,141)   | (14,303)  |
| Net cash used by investing activities   | (36,076)                | (37,517)   | (14,303)  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                         |            |           |
| Proceeds from long-term revolving credit facility                                 | 821,500                 | 308,836    | 109,333   |
| Repayments of long-term revolving credit facility                                 | (643,500)               | (197,813)  | (230,036) |
| Payment of deferred financing costs   | (6,217)                 | —          | —         |
| Proceeds from issuance of common stock  | 26,256                  | 28,551     | 1,623     |
| Excess tax benefit from stock based compensation                                  | 19,192                  | 5,590      | 359       |
| Treasury stock repurchased  | (365,928)               | (250,000)  | —         |
| Other   | (173)                   | (1,540)    | —         |
| Net cash used by financing activities   | (148,870)               | (106,376)  | (118,721) |
| <b>NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>           |                         |            |           |
| Increase (decrease) in cash and cash equivalents                                  | 57,744                  | 39,581     | (1,343)   |
| CASH AND CASH EQUIVALENTS, beginning of period                                    | 53,623                  | 14,042     | 15,385    |
| CASH AND CASH EQUIVALENTS, end of period  | \$ 111,367              | \$ 53,623  | \$ 14,042 |

Supplemental cash flow information:

Cash paid during the period for:

|                              |    |        |    |        |    |        |
|------------------------------|----|--------|----|--------|----|--------|
| Interest                     | \$ | 7,961  | \$ | 13,607 | \$ | 17,521 |
| Income taxes, net of refunds | \$ | 84,156 | \$ | 63,854 | \$ | 51,805 |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(In thousands, except per 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. Tempur World, Inc. was formed on January 1, 2000 to combine the manufacturing facilities and the global distribution capabilities of all TEMPUR® products, and Tempur-Pedic International Inc. was formed in 2002 to acquire Tempur World, Inc. This acquisition (Tempur Acquisition) was effective as of November 1, 2002.

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.

Certain prior period amounts have been reclassified to conform to the 2011 presentation of Consolidated Financial Statements, including a reclassification between current Deferred income tax assets and Prepaid expenses and other current assets. These changes do not materially impact previously reported subtotals within the Consolidated Financial Statements for any previous period presented.

(b) Basis of Consolidation. The accompanying financial statements include the accounts of Tempur-Pedic International and its subsidiaries. All subsidiaries are wholly-owned. Intercompany balances and transactions have been eliminated. As of December 31, 2011, the Company does not hold any interest in variable-interest entities. On January 29, 2010, the Company established a 51% interest in Tempur Shanghai Holding Ltd (a Hong Kong company). During December 2010, the Company purchased its noncontrolling interest in Tempur Shanghai Holding Ltd. Income attributable to the non-controlling interest was not material in 2010 and is presented within Other (expense) income, net within the Consolidated Statements of Income.

(c) Use of Estimates. The preparation of financial statements in conformity with United States Generally Accepted Accounting Principles (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.

(d) Foreign Currency. Assets and liabilities of non-U.S. subsidiaries, whose functional currency is the local currency, are translated into U.S. dollars at period-end exchange rates. Income and expense items are translated at the average rates of exchange prevailing during the period. The adjustments resulting from translating the financial statements of foreign subsidiaries are included in Accumulated other comprehensive loss (OCL), a component of Stockholders’ Equity, and included in net earnings only upon sale or liquidation of the underlying foreign subsidiary or affiliated company. Foreign currency transaction gains and losses are recognized in net earnings based on differences between

foreign exchanges rates on the transaction date and on the settlement date.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (In thousands, except per share amounts)

(e) Derivative Financial Instruments. The Company is required to recognize all of its derivative instruments as either assets or liabilities in the Consolidated Balance Sheets at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated, and is effective, as a hedge and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation. Gains and losses related to a hedge are either recognized in income immediately to offset the gain or loss on the hedged item or are deferred and reported as a component of Accumulated OCL in Stockholders' Equity and subsequently recognized in Net income when the hedged item affects Net income. The change in fair value of the ineffective portion of a financial instrument is recognized in Net income immediately. The gain or loss related to financial instruments that are not designated as hedges are recognized immediately in Net income.

Derivative financial instruments are used in the normal course of business to manage interest rate and foreign currency exchange risks. Credit risk is managed through the selection of sound financial institutions as counterparties. The Company does not apply hedge accounting to the foreign currency forward contracts used to offset currency-related changes in the fair value of foreign currency denominated assets and liabilities. These contracts are marked-to-market through earnings.

(f) Cash and Cash Equivalents. Cash and cash equivalents consist of all highly liquid investments with initial maturities of three months or less.

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

|                            | December 31, |           |
|----------------------------|--------------|-----------|
|                            | 2011         | 2010      |
| Finished goods             | \$ 67,532    | \$ 53,362 |
| Work-in-process            | 9,088        | 5,549     |
| Raw materials and supplies | 14,592       | 10,945    |
|                            | \$ 91,212    | \$ 69,856 |

(h) Property, Plant and Equipment. Property, plant and equipment are carried at cost at acquisition date and are depreciated using the straight-line method over their estimated useful lives as follows:

|                               | Estimated<br>Useful<br>Lives |
|-------------------------------|------------------------------|
| Buildings                     | 25-30 years                  |
| Computer equipment            | 3-5 years                    |
| Leasehold improvements        | 4-7 years                    |
| Machinery equipment           | 3-7 years                    |
| Office furniture and fixtures | 5-7 years                    |

Leasehold improvements are amortized over the shorter of the life of the lease or seven years. The Company allocates depreciation and amortization to cost of sales and within each line item of operating expenses.

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(i) Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset to the estimated future undiscounted net cash flows expected to be generated by the asset or group of assets. If estimated future undiscounted net cash flows are less than the carrying amount of the asset or group of assets, the asset is considered impaired and an expense is recorded in an amount required to reduce the carrying amount of the asset to its then fair value. Fair value generally is determined from estimated discounted future net cash flows (for assets held for use) or net realizable value (for assets held for sale).

(j) Goodwill and Other Intangible Assets. Intangible assets with finite useful lives are amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment whenever events or changes in circumstances indicate an impairment may have occurred. The Company performs an annual impairment test on all existing goodwill and other indefinite lived assets on October 1 of each year and whenever events or circumstances make it more likely than not that impairment may have occurred. The Company reviewed goodwill for impairment based on its identified reporting units, which include the Company's North American and International operating segments. In conducting the impairment test, the fair value of each of the Company's reporting units is compared to its respective carrying amount including goodwill. If the fair value exceeds the carrying amount, then no impairment exists. If the carrying amount exceeds the fair value, further analysis is performed to assess impairment. The Company's determination of fair value of the reporting units is based on an income approach, with an appropriate risk adjusted discount rate, and a market approach. Any identified impairment would result in an adjustment to the Company's results of operations. The Company also tests its indefinite-lived intangible assets, principally trademarks, for impairment using a "relief-from-royalty" method. Significant assumptions inherent in the methodologies are employed and include such estimates as royalty and discount rates. The Company performed its annual impairment test of goodwill and indefinite-lived intangible assets in 2011, 2010 and 2009, none of which resulted in the recognition of impairment charges. For further information on Goodwill and Other intangible assets see Note 3.

(k) 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 Consolidated Balance Sheets.

The Company had the following activity for sales returns from December 31, 2009 to December 31, 2011:

|                                 |          |
|---------------------------------|----------|
| Balance as of December 31, 2009 | \$ 4,233 |
| Amounts accrued                 | 46,978   |
| Returns charged to accrual      | (46,809) |
| Balance as of December 31, 2010 | 4,402    |
| Amounts accrued                 | 48,626   |
| Returns charged to accrual      | (47,743) |
| Balance as of December 31, 2011 | \$ 5,285 |

(l) 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 cost of sales 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 Consolidated Balance Sheets.

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The Company had the following activity for warranties from December 31, 2009 to December 31, 2011:

|                                 |          |
|---------------------------------|----------|
| Balance as of December 31, 2009 | \$ 4,052 |
| Amounts accrued                 | 4,160    |
| Warranties charged to accrual   | (4,131)  |
| Balance as of December 31, 2010 | 4,081    |
| Amounts accrued                 | 5,325    |
| Warranties charged to accrual   | (5,126)  |
| Balance as of December 31, 2011 | \$ 4,280 |

(m) **Income Taxes.** Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are also recognized for the estimated future effects of tax loss carry forwards. The effect of changes in tax rates on deferred taxes is recognized in the period in which the enactment dates change. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts expected to be realized. The Company accounts for uncertain foreign and domestic tax positions utilizing a proscribed recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

(n) **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.

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 and 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 Consolidated Balance Sheets was \$6,801 and \$7,437 as of December 31, 2011 and 2010, respectively.

The Company reflects all amounts billed to customers for shipping and handling in Net sales and the costs incurred from shipping and handling product in Cost of sales. Amounts included in Net sales for shipping and handling were approximately \$5,959, \$6,089 and \$5,207 for the years ended December 31, 2011, 2010 and 2009, respectively. Amounts included in Cost of sales for shipping and handling were \$101,224, \$87,651 and \$68,152 for the years ended December 31, 2011, 2010 and 2009, respectively.

(o) Cost of Sales. Costs associated with Net sales are recorded in Cost of sales. Costs of sales includes the costs of receiving, producing, inspecting, warehousing, insuring, and shipping goods during the period, as well as depreciation and amortization of long-lived assets used in these processes.

(p) Sales promotions and incentives. At the time of sale, the Company records an estimate for sales promotion and incentive costs. Examples of sales promotion and incentive programs include cash discounts, funds for promotional and market activities, volume-based incentive programs and other sales discounts and promotional programs. For customer incentives that must be earned, the Company makes estimates related to the contractual terms, customer performance and sales volume to determine the total amounts earned. The expense of each program is classified either as a reduction from revenues and presented within net sales, or as a component of selling and market expenses, in the Consolidated Statements of Income.

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(q) 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 amortized over the life of the program. Advertising costs are included in Selling and marketing expenses in the accompanying Consolidated Statements of Income. Advertising costs charged to expense were \$148,770, \$96,611 and \$69,324 for the years ended December 31, 2011, 2010 and 2009, respectively. Advertising costs include expenditures for shared advertising costs that the company reimburses to customers under its integrated advertising program. These obligations are accrued and expensed when the related revenues are recognized. Advertising costs deferred and included in Prepaid expenses and other current assets in the accompanying Consolidated Balance Sheets were \$9,065 and \$7,481 as of December 31, 2011 and 2010, respectively.

(r) 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 Consolidated Statements of Income. Research and development costs charged to expense were approximately \$9,905, \$7,417 and \$6,458 for the years ended December 31, 2011, 2010 and 2009, respectively.

(s) Stock-Based Compensation. The Company accounts for stock-based payment transactions in which the Company receives employee services in exchange for (a) equity instruments of the Company or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. Stock-based compensation cost for restricted stock units (RSUs), performance restricted stock units (PRSUs) and deferred stock units (DSUs) is measured based on the closing fair market value of the Company's common stock on the date of grant. Stock-based compensation cost for stock options is estimated at the grant date based on each option's fair-value as calculated by the Black-Scholes option-pricing model. The Company recognizes stock-based compensation cost as expense for awards other than its PRSUs ratably on a straight-line basis over the requisite service period. The Company recognizes stock-based compensation cost associated with its PRSUs over the requisite service period if it is probable that the performance conditions will be satisfied. The Company will recognize a benefit from stock-based compensation in equity if an incremental tax benefit is realized by following the ordering provisions of the tax law. Further information regarding stock-based compensation can be found in Note 9, "Stock-Based Compensation."

(t) Treasury Stock. The Board of Directors may authorize share repurchases of the Company's common stock (Share Repurchase Authorizations). Share repurchases under these authorizations may be made through open market transactions, negotiated purchase or otherwise, at times and in such amounts as the Company, and a committee of the Board, deem appropriate. Shares repurchased under Share Repurchase Authorizations are held in treasury for general corporate purposes, including issuances under various employee share-based award plans. Treasury shares are accounted for under the cost method and reported as a reduction of Stockholders' Equity. Share Repurchase Authorizations may be suspended, limited or terminated at any time without notice.

(u) Fair Value Measurements. The Company applies fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which the Company would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions and credit risk.

(v) Subsequent Events. On January 23, 2012, the Company's Board of Directors terminated the remaining authority under the July 2011 authorization, as amended in October 2011, and approved a new share repurchase authorization of up to \$250,000 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 Senior Credit Facility. This share repurchase program may be limited, suspended or terminated at any time without notice.

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## (2) Recently Issued Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued new guidance requiring the presentation of other comprehensive income in a statement presented with equal prominence to the other primary financial statements. The new guidance eliminates the current option to report other comprehensive income and its components in the statement of stockholders' equity and requires one of two alternatives for the presentation of items of Net income and other comprehensive income: (1) in a single continuous statement referred to as the statement of comprehensive income, or (2) in two separate, but consecutive statements. Under either alternative, each component of net income and each component of other comprehensive income, together with totals for each, as well as total comprehensive income would need to be displayed. The new guidance is effective beginning with the filing of our Form 10-Q for the three months ending March 31, 2012, with retrospective application required. As the new guidance only affects the presentation of other comprehensive income, it will not have a material impact on the Company's results of operations, financial condition, or cash flows.

## (3) 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, 2009          | \$ 89,929     | \$ 103,462    | \$ 193,391 |
| Foreign currency translation adjustments | 421           | 75            | 496        |
| Goodwill resulting from acquisition      | 18,581        | —             | 18,581     |
| Balance as of December 31, 2010          | \$ 108,931    | \$ 103,537    | \$ 212,468 |
| Foreign currency translation adjustments | (427)         | (105)         | (532)      |
| Goodwill resulting from acquisition      | —             | 1,337         | 1,337      |
| Balance as of December 31, 2011          | \$ 108,504    | \$ 104,769    | \$ 213,273 |

On April 1, 2010, the Company acquired its third party distributor in Canada. The total amount of cash paid for the acquisition was \$18,692. Additional payments may be made to the former owners if certain financial targets are met; the fair value of these payments as of the acquisition date was \$6,241. Accordingly, the acquisition date fair value of the consideration transferred was \$24,933. During 2011, the Company reduced the fair value of the contingent consideration and recorded a benefit to the income statement of \$1,825.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The Company has finalized its purchase price allocation.

|                               |           |
|-------------------------------|-----------|
| Net working capital           | \$ 456    |
| Deferred tax liability        | (1,955)   |
| Property, plant and equipment | 322       |
| Intangible assets             | 7,529     |
| Goodwill                      | 18,581    |
| Total purchase price          | \$ 24,933 |

Intangible assets are comprised of \$5,639 related to reacquired rights with a useful life of 3 years and \$1,890 related to customer relationships with a useful life of 5 years. The goodwill was assigned to the North American segment and

the North American reporting unit for the Company's annual goodwill impairment testing. None of the goodwill is expected to be deductible for income tax purposes.

On July 4, 2011, the Company acquired the business of its third party distributor in South Korea. The Company paid \$4,566 in cash to acquire this entity with additional future payments to former owners required based on certain financial and operational targets. Assets acquired include certain Intangible assets, Inventories, Property, plant and equipment, and Prepaid expenses and other current assets, with the remaining consideration allocated to Goodwill.



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

|  | Useful Lives (Years) | December 31, 2011     |                          |                     |                  | December 31, 2010     |                          |                     |  |
|--|----------------------|-----------------------|--------------------------|---------------------|------------------|-----------------------|--------------------------|---------------------|--|
|  |                      | 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             | \$ 14,667                | \$ 1,333            | \$ 16,000        | \$ 13,067             | \$ 2,933                 |                     |  |
| Patents & other trademarks                     | 5-20                 | 12,546                | 9,180                    | 3,366               | 12,063           | 8,575                 | 3,488                    |                     |  |
| Customer database                              | 5                    | 4,928                 | 4,928                    | —                   | 4,813            | 4,691                 | 122                      |                     |  |
| Foam formula                                   | 10                   | 3,700                 | 3,392                    | 308                 | 3,700            | 3,022                 | 678                      |                     |  |
| Reacquired rights                              | 3                    | 5,638                 | 3,289                    | 2,349               | 5,767            | 1,440                 | 4,327                    |                     |  |
| Customer relationships                         | 5                    | 4,989                 | 854                      | 4,135               | 2,492            | 295                   | 2,197                    |                     |  |
| <b>Total</b>                                   |                      | <b>\$ 102,801</b>     | <b>\$ 36,310</b>         | <b>\$ 66,491</b>    | <b>\$ 99,835</b> | <b>\$ 31,090</b>      | <b>\$ 68,745</b>         |                     |  |

Amortization expense relating to intangible assets for the Company was \$5,376, \$4,362 and \$2,414 for the years ended December 31, 2011, 2010 and 2009, respectively. No impairments of goodwill or other intangible assets have adjusted the gross carrying amount of these assets in any period.

Annual amortization of intangible assets is expected to be as follows:

| Year Ending December 31, |          |
|--------------------------|----------|
| 2012                     | \$ 5,074 |
| 2013                     | 2,023    |
| 2014                     | 1,354    |
| 2015                     | 966      |
| 2016                     | 602      |

## (4) Long-term Debt

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

|                         | 2011 | December 31,<br>2010 |
|-------------------------|------|----------------------|
| Senior Credit Facility: |      |                      |

|   |    |         |    |         |
|---|----|---------|----|---------|
| Domestic Long-Term Revolving Credit Facility payable to lenders, interest at<br>Base Rate or LIBOR plus applicable margin (2.05% and 1.87% as of<br>December 31, 2011 and December 31, 2010, respectively),<br>commitment through and due June 28, 2016 | \$ | 585,000 | \$ | 407,000 |
| Long-term debt  | \$ | 585,000 | \$ | 407,000 |

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(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.

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. The domestic credit facility is a five-year, \$745,000 revolving credit facility. The foreign credit facility is a five-year, \$25,000 revolving credit facility. 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 December 31, 2011. After giving effect to Contingent Liabilities and \$585,000 in borrowings under the Revolvers, total availability under the Revolvers was \$184,010 as of December 31, 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 0.50%. 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 0.375% to 0.50%.

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 December 31, 2011.

In conjunction with the Company amending and restating its Senior Credit Facility, \$6,217 of deferred financing costs were capitalized and will be amortized over the five year extension.

On August 8, 2011, the Company entered into a four-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 6, "Derivative Financial Instruments" for additional information regarding the Company's derivative instruments, including this interest rate swap.

(5) Fair Value of Financial Instruments

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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The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement. At December 31, 2011 and 2010, the Company had an interest rate swap, foreign currency forward contracts and contingent considerations 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 December 31, 2011 |   |   |  |
|------------------------------------|--|---|---|--|
|                                    | December 31,<br>2011                         | Using:<br>Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Liabilities:</b>                |  |   |   |  |
| Foreign currency forward contracts | \$ 935                                       | \$ —  | \$ 935  | \$ —   |
| Interest rate swap                 | \$ 2,616                                     | \$ —  | \$ 2,616  | \$ —   |

|                                    | Fair Value Measurements at December 31, 2010 |   |   |  |
|------------------------------------|--|---|---|--|
|                                    | December 31,<br>2010                         | Using:<br>Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Liabilities:</b>                |  |   |   |  |
| 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 (4)(b)) are at variable interest rates and accordingly their carrying amounts approximate fair value.

**(6) 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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## Interest Rate Risk

The Company is exposed to changes in interest rates on its Senior Credit Facility. In order to manage this risk, on August 8, 2011, the Company entered into a four-year interest rate swap agreement to manage interest costs and the risk associated with changing interest rates. The Company designated this interest rate swap as a cash flow hedge of floating rate borrowings and expects the hedge to be highly effective in offsetting fluctuations in the designated interest payments resulting from changes in the benchmark interest rate. The gains and losses on the designated swap agreement will offset losses and gains on the transactions being hedged. The Company formally documented the effectiveness of this qualifying hedge instrument (both at the inception of the swap and on an ongoing basis) in offsetting changes in cash flows of the hedged transaction. The fair value of the interest rate swap is calculated as described in Note 5, "Fair Value of Financial Instruments", taking into consideration current interest rates and the current creditworthiness of the counterparties or the Company, as applicable.

As a result of this swap, the Company will pay interest at a fixed rate and receive payment at a variable rate beginning on December 30, 2011. The swap effectively fixes the floating LIBOR-based interest rate to 1.25% on \$250,000 of the outstanding balance under the Senior Credit Facility, with the outstanding balance subject to the swap declining over time. The interest rate swap expires on December 30, 2015. The Company will select the LIBOR-based rate on the hedged portion of the Senior Credit Facility during the term of the swap. The effective portion of the change in value of the swap is reflected as a component of comprehensive income and recognized as Interest expense, net as payments are paid or accrued. The remaining gain or loss in excess of the cumulative change in the present value of the future cash flows of the hedged item, if any (i.e., the ineffective portion) or hedge components excluded from the assessment of effectiveness are recognized as Interest expense, net during the current period.

## Foreign Currency Exposures

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 effect 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 5, "Fair Value of Financial Instruments" taking into consideration foreign currency rates and the current creditworthiness of the counterparties or the Company, as applicable.

As of December 31, 2011, the Company had foreign currency forward contracts with expiration dates ranging from January 31, 2012 through April 27, 2012. The changes in fair value of these foreign currency hedges are included as a component of Other (expense) income, net. As of December 31, 2011, the Company had the following outstanding foreign currency forward contracts:

| Foreign Currency    | Currency<br>Denomination |         |
|---------------------|--------------------------|---------|
| Great Britain Pound | £                        | 2,146   |
| Japanese Yen        | ¥                        | 472,621 |
| Swedish Krona       | kr.                      | 18,836  |

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|                      |     |       |
|----------------------|-----|-------|
| Norwegian Krone      | kr. | 3,591 |
| Australian Dollar    | \$  | 1,831 |
| New Zealand Dollar   | \$  | 2,046 |
| Singapore Dollar     | \$  | 513   |
| United States Dollar | \$  | 7,234 |

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

|  | Liability Derivatives                          |            |  |            |
|--|--|------------|--|------------|
|  | December 31, 2011                              |            | December 31, 2010                              |            |
|  | Balance Sheet<br>Location                      | Fair Value | Balance Sheet<br>Location                      | Fair Value |
| <b>Derivatives designated as hedging instruments</b>     |  |            |  |            |
| Interest rate swap – current                             | Accrued expenses and other current liabilities | \$ 1,471   | Accrued expenses and other current liabilities | \$ 1,430   |
| Interest rate swap – non-current                         | Other non-current liabilities                  | 1,145      | Other non-current liabilities                  | —          |
|  |  | \$ 2,616   |  | \$ 1,430   |
| <b>Derivatives not designated as hedging instruments</b> |  |            |  |            |
| Foreign exchange forward contracts                       | Accrued expenses and other current liabilities | \$ 935     | Accrued expenses and other current liabilities | \$ 676     |
|  |  | \$ 3,551   |  | \$ 2,106   |

The effect of derivative instruments on the Consolidated Statements of Income for the year ended December 31, 2011 was as follows:

| Derivatives                                   | Amount of Gain/(Loss) Recognized in               | 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 Portion and Excluded from Effectiveness Testing | Amount of Gain/(Loss) Recognized in Income on Derivative Portion and Excluded from Effectiveness Testing |
|---|---|---|---|--|--|
| Designated as Cash Flow Hedging Relationships | Accumulated OCL on Derivative (Effective Portion) | OCL into Income (Effective Portion)   | Interest expense, net   | Interest expense, net  |  |
| Interest rate swap                            | \$ (1,187)  |   | \$ (1,446)  |  | \$ —   |

Derivatives Not Designated as Hedging Instruments

Location of Gain/(Loss)

|                                    | Recognized in Income on<br>Derivative | Amount of<br>Gain/(Loss)<br>Recognized in<br>Income<br>on Derivative |
|------------------------------------|---------------------------------------|--|
| Foreign exchange forward contracts | Other (expense) income, net           | \$ 937   |

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For the year ended December 31, 2010:

|  | Amount of<br>Gain/(Loss)<br>Recognized in<br>Accumulated<br>OCL on<br>Derivative<br>(Effective<br>Portion) | Location of<br>Gain/(Loss)<br>Reclassified from<br>Accumulated OCL<br>into<br>Income<br>(Effective Portion) | Amount of<br>Gain/(Loss)<br>Reclassified<br>from<br>Accumulated<br>OCL<br>into Income<br>(Effective<br>Portion) | Location of<br>Gain/(Loss)<br>Recognized in<br>Income on<br>Derivative<br>(Ineffective<br>Portion and Amount<br>Excluded from<br>Effectiveness<br>Testing) | Amount of<br>Gain/(Loss)<br>Recognized<br>in Income<br>on Derivative<br>(Ineffective<br>Portion<br>and Amount<br>Excluded<br>from<br>Effectiveness<br>Testing) |
|--|--|---|---|--|--|
| Derivatives<br>Designated as Cash<br>Flow Hedging<br>Relationships | \$ 5,435   | Interest expense, net   | \$ (6,642)  | Interest expense, net  | \$ —   |

| Derivatives Not Designated as Hedging Instruments | Location of Gain/(Loss)<br>Recognized in Income on<br>Derivative | Amount of<br>Gain/(Loss)<br>Recognized in<br>Income<br>on Derivative |
|---|--|--|
| Foreign exchange forward contracts                | Other (expense) income, net                                      | \$ (2,309)   |

## (7) Stockholders' Equity

(a) Capital stock. Tempur-Pedic International has 300,000 authorized shares of common stock with \$0.01 per share par value and 10,000 authorized shares of preferred stock. The holders of the common stock are entitled to one vote for each share held of record on all matters submitted to a vote of stockholders. Subject to preferences that may be applicable to any outstanding preferred stock, holders of 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 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.

Tempur-Pedic International is authorized to issue up to 10,000 shares of preferred stock, \$0.01 par value per share. The Board of Directors is authorized, subject to any limitations prescribed by law, without further vote or action by the stockholders, to issue from time to time shares of preferred stock in one or more series. Each such series of preferred stock will have such number of shares, designations, preferences, voting powers, qualifications, and special or relative rights or privileges as determined by the Board of Directors, which may include, among others, dividend rights, voting rights, redemption and sinking fund provisions, liquidation preferences, conversion rights and preemptive rights.



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(b) Share Repurchase Programs. During 2011, the Company purchased 6,511 shares of the Company's common stock for a total cost of \$368,493 pursuant to authorizations made by the Company's Board of Directors. On January 23, 2012, the Company's Board of Directors terminated the remaining authority under the July 2011 authorization, as amended in October 2011, and approved a new share repurchase authorization of up to \$250,000 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 Senior Credit Facility. This share repurchase program may be limited, suspended or terminated at any time without notice.

## (8) Other Items

## (a) Property, plant and equipment.

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

|  | December 31,<br>2011 | 2010       |
|--|----------------------|------------|
| Land and buildings   | \$ 121,794           | \$ 121,188 |
| Machinery and equipment, furniture and fixtures, and other | 225,521              | 208,310    |
| Construction in progress                                   | 14,777               | 9,858      |
|  | 362,092              | 339,356    |
| Accumulated depreciation and amortization                  | (201,590)            | (179,549)  |
|  | \$ 160,502           | \$ 159,807 |

Depreciation expense for the Company was \$28,919, \$27,999 and \$29,010 for the years ended December 31, 2011, 2010 and 2009, respectively.

## (b) Accrued expenses and other current liabilities.

Accrued expenses and other current liabilities consisted of the following:

|                                     | December 31,<br>2011 | 2010      |
|-------------------------------------|----------------------|-----------|
| Salary and related expenses         | \$ 24,265            | \$ 22,171 |
| Accrued unrecognized tax benefits   | 16,105               | 12,035    |
| Accrued sales and value added taxes | 8,497                | 10,614    |
| Advertising accrual                 | 6,988                | 6,981     |
| Warranty accrual                    | 4,280                | 4,081     |
| Sales returns                       | 5,285                | 4,402     |
| Other                               | 27,317               | 25,185    |
|                                     | \$ 92,737            | \$ 85,469 |



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(c) Accumulated other comprehensive loss.

Accumulated other comprehensive loss consisted of the following:

|   | December 31,<br>2011 | 2010       |
|---|----------------------|------------|
| Derivative instruments accounted for as hedges, net of tax of \$1,020 and \$558 | \$ (1,596)           | \$ (872)   |
| Foreign currency translation  | (13,090)             | (5,316)    |
| Accumulated other comprehensive loss  | \$ (14,686)          | \$ (6,188) |

(9) Stock-based Compensation

Tempur-Pedic International has two stock-based compensation plans which provide for grants of non-qualified and incentive stock options, stock appreciation rights, restricted stock and stock unit awards, performance shares, stock grants and performance based awards to employees, non-employee directors, consultants and Company advisors. The plans under which equity awards may be granted are the 2002 Option Plan and the Amended and Restated 2003 Equity Incentive Plan, as amended, (the 2003 Plan). Tempur-Pedic International also has a stock-based compensation plan which permits eligible employees to purchase its shares at a discounted price, subject to certain guidelines set forth by its 2003 Employee Stock Purchase Plan, as amended (ESPP). It is the policy of the Company to issue stock out of Treasury shares upon issuance or exercise of share-based awards. The Company believes that awards and purchases made under these plans better align the interests of the plan participants with those of its stockholders.

The 2002 Option Plan was adopted on November 1, 2002 and provides for grants of stock options to purchase shares of common stock to employees and directors of the Company. Options granted under the 2002 Option Plan that qualify as incentive stock options, as defined by the Internal Revenue Code of 1986, as amended (the Code), must have an exercise price of not less than the fair market value of Tempur-Pedic International's common stock at the date of grant. Options granted under the 2002 Option Plan provided for vesting terms as determined by the Board of Directors at the time of grant, which are generally based on 4 years of continuous service. Options can be exercised up to 10 years from the grant date and up to 5 years from the grant date for any stockholders who own 10% or more of the total combined voting power of all shares of stock of Tempur-Pedic International. Upon the exercise of all outstanding options under the 2002 Option Plan, Tempur-Pedic International will issue a maximum of 6,534 shares of common stock, subject to certain adjustment provisions. In December 2003, the Company's Board of Directors adopted a resolution that prohibited further grants under the 2002 Stock Option Plan.

The ESPP permits eligible employees to purchase up to certain limits, as set forth in the ESPP, of Tempur-Pedic International's common stock annually over the course of two semi-annual offering periods at a price of no less than 85% of the price per share of Tempur-Pedic International's common stock either at the beginning or the end of each six-month offering period, whichever is less. The Compensation Committee of the Board of Directors administers the ESPP. The Board of Directors may amend or terminate the ESPP. The ESPP is intended to comply with the requirements of Section 423 of the Code. The Company may issue a maximum of 500 shares of its common stock under the ESPP. Effective February 1, 2010, the Company suspended offerings under the ESPP indefinitely.

The 2003 Plan is administered by the Compensation Committee of the Board of Directors, which, together with the Board of Directors, has the exclusive authority to administer the 2003 Plan, including the power to determine

eligibility to receive awards, the types and number of shares of stock subject to the awards, the price and timing of awards and the acceleration or waiver of any vesting and performance of forfeiture restrictions, in each case subject to the terms of the 2003 Plan. Any of the Company's employees, non-employee directors, consultants and Company advisors, as determined by the Compensation Committee, may be selected to participate in the 2003 Plan. Tempur-Pedic International may issue a maximum of 11,500 shares of its common stock under the 2003 Plan.



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In 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 and 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 years ended December 31, 2011 and 2010. The maximum number of shares to be awarded under the RSUs granted during the years ended December 31, 2011 and 2010 will be 443 shares and 411 shares respectively; and will vest, if earned, at the end of the three-year performance period ending on December 31, 2013 and December 31, 2012, respectively. Actual payout under the RSUs is dependent upon the achievement of certain financial goals, based on Net sales and Earnings Before Interest and Taxes (EBIT) margin targets. The Company recognized compensation expense of \$9,474 and \$2,330 associated with the RSUs during the years ended December 31, 2011 and 2010, respectively. Based on current estimates of the performance metrics, unrecognized compensation expense with respect to the RSUs was \$8,886 as of December 31, 2011, which is expected to be recorded over the weighted average remaining life of 1.5 years. A summary of Tempur-Pedic International's unvested RSUs as of December 31, 2011 and 2010 and changes during the years ended December 31, 2011 and 2010 are presented below:

|                                      | Shares | Weighted<br>Average Grant<br>Date Fair Value |
|--------------------------------------|--------|--|
| Awards unvested at December 31, 2009 |        | —  |
| Granted                              | 137    | 28.48  |
| Vested                               | —      | —  |
| Forfeited                            | —      | —  |
| Awards unvested at December 31, 2010 | 137    | \$ 28.48                                     |
| Granted                              | 148    | 46.68  |
| Vested                               | —      | —  |
| Forfeited                            | —      | —  |
| Awards unvested at December 31, 2011 | 285    | \$ 37.93                                     |

During the year no RSUs transferred ownership. The aggregate intrinsic value of RSUs outstanding as of December 31, 2011 was \$14,943.

The Company uses the Black-Scholes option pricing model to calculate the fair value of stock options granted. The assumptions used in the Black-Scholes pricing model for the years ended December 31, 2011, 2010 and 2009 are set forth in the following table. Expected volatility is based on the unbiased standard deviation of Tempur-Pedic International's common stock over the option term. The expected life of the options represents the period of time that the Company expects the options granted to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of the grant of the option for the expected term of the instrument. The dividend yield reflects an estimate of dividend payouts over the term of the award.

|                                    | Year Ended December 31, |          |          |
|------------------------------------|-------------------------|----------|----------|
|                                    | 2011                    | 2010     | 2009     |
| Expected volatility range of stock | 72 – 74 %               | 69 – 84% | 62 – 92% |

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|   |             |            |            |
|---|-------------|------------|------------|
| Expected life of option, range in years | 3.0 – 4.0   | 2.0 – 5.0  | 2.0 – 5.0  |
| Risk-free interest rate range           | 0.7 – 1.7 % | 1.0 – 2.7% | 1.0 – 2.8% |
| Expected dividend yield on stock        | 0.0 – 0.7 % | 0.0 – 1.6% | 0.0 – 5.2% |

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A summary of Tempur-Pedic International's unvested shares relating to stock options as of December 31, 2011 and 2010 and changes during the years ended December 31, 2011 and 2010 are presented below:

|                                       | Shares  | Weighted<br>Average Grant<br>Date Fair Value |
|---------------------------------------|---------|--|
| Options unvested at December 31, 2009 | 3,714   | \$ 4.33                                      |
| Granted                               | 198     | 13.95  |
| Vested                                | (1,499) | 5.26   |
| Forfeited                             | (18)    | 5.57   |
| Options unvested at December 31, 2010 | 2,395   | \$ 4.57                                      |
| Granted                               | 91      | 25.76  |
| Vested                                | (1,093) | 5.01   |
| Forfeited                             | (53)    | 4.59   |
| Options unvested at December 31, 2011 | 1,340   | \$ 5.44                                      |

A summary of stock options activity under the 2002 Option Plan and 2003 Plan is presented below:

|  | Shares  | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(Years) | Aggregate<br>Intrinsic<br>Value |
|--|---------|--|--|---------------------------------|
| Options outstanding at December 31, 2009 | 6,819   | \$ 13.47                                 |  |                                 |
| Granted                                  | 198     | 28.65                                    |  |                                 |
| Exercised                                | (1,831) | 15.59                                    |  |                                 |
| Terminated                               | (19)    | 13.52                                    |  |                                 |
| Options outstanding at December 31, 2010 | 5,167   | \$ 13.31                                 |  |                                 |
| Granted                                  | 91      | 49.19                                    |  |                                 |
| Exercised                                | (1,797) | 19.27                                    |  |                                 |
| Terminated                               | (53)    | 11.61                                    |  |                                 |
| Options outstanding at December 31, 2011 | 3,408   | \$ 11.15                                 | 6.47   | 140,977                         |
| Options exercisable at December 31, 2011 | 2,015   | \$ 14.32                                 | 6.01   | 76,981                          |

The total intrinsic value of options exercised for the years ended December 31, 2011, 2010 and 2009 was \$59,221, \$29,881 and \$1,604, respectively.

The grant date fair value of stock options is recognized as compensation expense on a straight-line basis over the requisite service period, and the expense is expected to be recognized over a weighted-average remaining period of 1.5 years as of December 31, 2011. The total value of options vested during the years ended December 31, 2011, 2010 and 2009 was \$5,468, \$7,943 and \$7,910, respectively. For the years ended December 31, 2011, 2010 and 2009, the Company recognized \$5,197, \$7,509 and \$8,513, respectively, of stock-based compensation related to stock options granted under the 2003 Plan. As of December 31, 2011, there was \$4,191 of unearned stock-based compensation expense related to these options. The future amortization of these unearned stock-based compensation costs will be

\$2,943 in 2012; \$1,100 in 2013; and \$148 in 2014.

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The Company granted 9 awards during the year ended December 31, 2011 that consisted of restricted stock units (RSUs) and deferred stock units (DSUs). For the years ended December 31, 2011, 2010 and 2009, the Company recognized \$2,022, \$1,754 and \$146, respectively, of stock-based compensation expense related to RSUs and DSUs. As of December 31, 2011, there was \$1,972 of unrecognized compensation expense associated with the RSUs and DSUs, which is expected to be recorded over the weighted average remaining vesting period of 1.1 years. A summary of Tempur-Pedic International's unvested RSUs and DSUs as of December 31, 2011 and 2010 and changes during the years ended December 31, 2011 and 2010 are presented below:

|                                      | Shares | Weighted<br>Average Grant<br>Date Fair Value |
|--------------------------------------|--------|--|
| Awards unvested at December 31, 2009 | 9      | \$ 14.98                                     |
| Granted                              | 188    | 28.70  |
| Vested                               | (15)   | 22.33  |
| Forfeited                            | (1)    | 28.39  |
| Awards unvested at December 31, 2010 | 181    | \$ 28.55                                     |
| Granted                              | 9      | 61.72  |
| Vested                               | (11)   | 49.02  |
| Forfeited                            | (6)    | 28.37  |
| Awards unvested at December 31, 2011 | 173    | \$ 28.98                                     |

The aggregate intrinsic value of RSU and DSUs outstanding as of December 31, 2011 was \$9,734.

Cash received from options exercised under all stock-based compensation plans, including cash received from options issued from treasury shares for the years ended December 31, 2011, 2010 and 2009 was \$26,256, \$28,551 and \$1,623, respectively.

#### (10) Commitments and Contingencies

(a) Lease Commitments. The Company has various operating leases that call for annual rental payments due in equal monthly installments and a lease with a rent free occupancy period. The Company's policy is to recognize expense for lease payment, including those with escalating provisions and rent free periods, on a straight-line basis over the lease term. Operating lease expenses were \$8,390, \$6,330, and \$6,148 for the years ended December 31, 2011, 2010 and 2009, respectively.

Future minimum lease payments at December 31, 2011 under these non-cancelable leases are as follows:

|                         |           |
|-------------------------|-----------|
| Year Ended December 31, |           |
| 2012                    | \$ 7,259  |
| 2013                    | 4,581     |
| 2014                    | 3,324     |
| 2015                    | 3,055     |
| 2016                    | 2,385     |
| Thereafter              | 2,955     |
|                         | \$ 23,559 |

(b) Purchase Commitments. As of December 31, 2011, the Company had outstanding commitments of approximately \$15,700 for capital expenditures related to the construction of the Company's corporate headquarters in Lexington, Kentucky. The Company will, from time to time, enter into limited purchase commitments for the purchase of certain raw materials. Amounts committed under these programs are not significant as of December 31, 2011 and 2010.

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(c) 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 operations.

(d) 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.

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## (11) Income Taxes

Provision for Income Taxes. The Company's effective income tax provision differs from the amount calculated using the statutory U.S. federal income tax rate, principally due to the following:

|  | Year Ended December 31,<br>2011 |  | 2010      |  | 2009      |  |
|--|---------------------------------|--|-----------|--|-----------|--|
|  | Amount                          | Percentage<br>of Income<br>Before<br>Taxes | Amount    | Percentage<br>of Income<br>Before<br>Taxes | Amount    | Percentage<br>of Income<br>Before<br>Taxes |
| Statutory U.S. federal income tax          | \$ 114,937                      | 35.0%                                      | \$ 80,803 | 35.0%                                      | \$ 44,809 | 35.0%                                      |
| State income taxes, net of federal benefit | 7,925                           | 2.4  | 5,303     | 2.3  | 1,611     | 1.3  |
| Foreign tax differential                   | (9,436)                         | (2.9)                                      | (8,581)   | (3.7)                                      | (7,153)   | (5.6)                                      |
| Change in valuation allowances             | (5,879)                         | (1.8)                                      | (957)     | (0.4)                                      | 1,037     | 0.8  |
| Uncertain tax positions                    | 4,070                           | 1.2  | (642)     | (0.3)                                      | 1,532     | 1.2  |
| Subpart F income                           | 3,239                           | 1.0  | 2,927     | 1.3  | 2,082     | 1.6  |
| Manufacturing deduction                    | (5,046)                         | (1.5)                                      | (3,998)   | (1.7)                                      | (975)     | (0.8)                                      |
| Permanent and other                        | (1,027)                         | (0.3)                                      | (1,135)   | (0.6)                                      | 101       | 0.1  |
| Effective income tax provision             | \$ 108,783                      | 33.1%                                      | \$ 73,720 | 31.9%                                      | \$ 43,044 | 33.6%                                      |

Subpart F income represents interest and royalties earned by a foreign subsidiary as well as sales made by certain foreign subsidiaries outside of their country of incorporation. Under the Code, such income is taxable to Tempur-Pedic International as if earned directly by Tempur-Pedic International.

The Company has not provided for U.S. federal, state income and foreign withholding taxes on \$299,150 of undistributed earnings from non-U.S. operations as of December 31, 2011 because the Company intends to reinvest such earnings indefinitely outside of the United States. If Tempur-Pedic International were to distribute these earnings, foreign tax credits may become available under current law to reduce the resulting U.S. income tax liability. It is not practicable to estimate the amount of U.S. tax that might be payable if these earnings were ever to be remitted to the U.S.

The following sets forth the amount of Income before income taxes attributable to each of the Company's operating segments for the years ended December 31, 2011, 2010 and 2009:

|                             | Year Ended December 31, |      |      |
|-----------------------------|-------------------------|------|------|
|                             | 2011                    | 2010 | 2009 |
| Income before income taxes: |                         |      |      |

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|               |    |         |    |         |    |         |
|---------------|----|---------|----|---------|----|---------|
| North America | \$ | 224,605 | \$ | 137,697 | \$ | 49,703  |
| International |    | 103,786 |    | 93,168  |    | 78,334  |
| Consolidated  | \$ | 328,391 | \$ | 230,865 | \$ | 128,037 |

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U.S. GAAP prescribes a recognition threshold and measurement attribute for the accounting and financial statement disclosure of tax positions taken or expected to be taken in a tax return. The evaluation of a tax position is a two-step process. The first step requires the Company to determine whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. The second step requires the Company to recognize in the financial statements each tax position that meets the more likely than not criteria, measured at the largest amount of benefit that has a greater than 50-percent likelihood of being realized. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|  |           |
|--|-----------|
| Balance as of December 31, 2009  | \$ 10,111 |
| Additions based on tax positions related to 2010   | 376       |
| Additions for tax positions of prior years   | 132       |
| Reductions for tax positions as a result of a lapse of applicable statute of limitations | (267)     |
| Settlements of uncertain tax positions with tax authorities                              | (1,484)   |
| Balance as of December 31, 2010  | \$ 8,868  |
| Additions based on tax positions related to 2011   | 1,943     |
| Additions for tax positions of prior years   | 2,577     |
| Settlements of uncertain tax positions with tax authorities                              | (105)     |
| Balance as of December 31, 2011  | \$ 13,283 |

The entire amount of unrecognized tax benefits would impact the effective tax rate if recognized. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. During the years ended December 31, 2011, 2010 and 2009, the Company recognized approximately \$(344), \$732 and \$538 in interest and penalties, respectively, in income tax expense. The Company had approximately \$2,822 and \$3,166 of accrued interest and penalties at December 31, 2011 and 2010, respectively.

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. 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 met to discuss the Company's Bilateral APA during the first and fourth quarters 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.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The Company was notified of an impending tax examination in the U.S. for the years 2008 and 2009. With few exceptions, the Company is no longer subject to tax examinations by the IRS 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.

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The Company's foreign net operating losses (NOLs) were \$36,787 and \$31,712 as of December 31, 2011 and 2010, respectively. These NOLs expire at various dates through 2020. The Company has established a valuation allowance for net operating loss carryforwards and certain other deferred tax assets related to certain foreign operations. Management believes that, based on a number of factors, the available objective evidence creates sufficient uncertainty regarding the realizability of these foreign NOLs and certain other timing differences related to some of its foreign operations. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion of all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income, management believes it is more likely than not the Company will realize the benefits of the deferred tax assets, other than those related to some of its foreign operations as discussed above. However, there can be no assurance that such assets will be realized if circumstances change. During 2011, valuation allowances of \$5,879 were reversed in certain foreign jurisdictions as earnings trends over the last few years now make it more likely than not that the deferred tax assets in these jurisdictions will be realized.

The Income tax provision includes federal, state, and foreign income taxes currently payable and those deferred or prepaid because of temporary differences between financial statement and tax bases of assets and liabilities. The Company records income taxes under the liability method. Under this method, deferred income taxes are recognized for the estimated future tax effects of differences between the tax bases of assets and liabilities and their financial reporting amounts based on enacted tax laws.

The Income tax provision consisted of the following:

|                                   | Year Ended December 31, |                  |                  |
|-----------------------------------|-------------------------|------------------|------------------|
|                                   | 2011                    | 2010             | 2009             |
| <b>Current provision</b>          |                         |                  |                  |
| Federal                           | \$ 76,898               | \$ 40,483        | \$ 27,666        |
| State                             | 11,988                  | 7,053            | 4,144            |
| Foreign                           | 28,425                  | 21,238           | 18,510           |
| <b>Total current</b>              | <b>117,311</b>          | <b>68,774</b>    | <b>50,320</b>    |
| <b>Deferred provision</b>         |                         |                  |                  |
| Federal                           | (1,435)                 | 2,494            | (9,357)          |
| State                             | (155)                   | 285              | (738)            |
| Foreign                           | (6,938)                 | 2,167            | 2,819            |
| <b>Total deferred</b>             | <b>(8,528)</b>          | <b>4,946</b>     | <b>(7,276)</b>   |
| <b>Total Income tax provision</b> | <b>\$ 108,783</b>       | <b>\$ 73,720</b> | <b>\$ 43,044</b> |

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The net deferred tax assets and liabilities recognized in the Consolidated Balance Sheet consisted of the following:

|                                | December 31, |             |
|--------------------------------|--------------|-------------|
|                                | 2011         | 2010        |
| Deferred tax assets:           |              |             |
| Inventories                    | \$ 1,800     | \$ 1,988    |
| Net operating losses           | 9,932        | 9,932       |
| Property, plant and equipment  | 3,810        | 3,231       |
| Accrued expenses and other     | 18,749       | 17,635      |
| Total deferred tax assets      | 34,291       | 32,786      |
| Valuation allowances           | (2,937)      | (8,816)     |
| Total net deferred tax assets  | 31,354       | 23,970      |
| Deferred tax liabilities:      |              |             |
| Property, plant and equipment  | (11,685)     | (11,943)    |
| Intangible assets              | (23,011)     | (24,596)    |
| Accrued expenses and other     | (6,494)      | (6,021)     |
| Total deferred tax liabilities | (41,190)     | (42,560)    |
| Net deferred tax liabilities   | \$ (9,836)   | \$ (18,590) |

**(12) Major Customers**

The top five customers accounted for approximately 20%, 20% and 19% of the Company's Net sales for the years ended December 31, 2011, 2010 and 2009, respectively. The top five customers also accounted for approximately 19% and 21% of accounts receivable as of December 31, 2011 and 2010, respectively.

**(13) Benefit Plan**

The Company has a defined contribution plan (the Plan) whereby eligible employees may contribute up to 15% of their pay subject to certain limitations as defined by the Plan. Employees are eligible to participate in the Plan after 90 days and are eligible to receive matching contributions upon one year of employment with the Company. The Plan provides a 100% match of the first 3% and 50% of the next 2% of eligible employee contributions. All matching contributions vest immediately. The Company incurred \$1,477, \$1,123 and \$1,064 of expenses associated with the Plan for the years ended December 31, 2011, 2010 and 2009, respectively.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
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## (14) Earnings Per Common Share

|  | Year Ended December 31, |            |           |
|--|-------------------------|------------|-----------|
|  | 2011                    | 2010       | 2009      |
| <b>Numerator:</b>  |                         |            |           |
| Net income   | \$ 219,608              | \$ 157,145 | \$ 84,993 |
| <b>Denominator:</b>  |                         |            |           |
| Denominator for basic earnings per common share — weighted average shares            | 67,070                  | 70,348     | 74,934    |
| <b>Effect of dilutive securities:</b>  |                         |            |           |
| Employee stock based compensation  | 2,079                   | 2,444      | 1,114     |
| Denominator for diluted earnings per common share — adjusted weighted average shares | 69,149                  | 72,792     | 76,048    |
| Basic earnings per common share  | \$ 3.27                 | \$ 2.23    | \$ 1.13   |
| Diluted earnings per common share  | \$ 3.18                 | \$ 2.16    | \$ 1.12   |

The Company excluded 6 and 30 and 2,331 shares issuable upon exercise of outstanding stock options for the years ended December 31, 2011, 2010 and 2009, respectively, from the Diluted earnings per common share computation because their exercise price was greater than the average market price of the Company's common stock or they were otherwise anti-dilutive. Holders of non-vested stock-based compensation awards do not maintain voting rights or maintain rights to receive any dividends thereon.

## (15) 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. Substantially all of the net sales from external customers and long-lived assets included in the tables below for our North American segment relate to our U.S. operations. 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:

|                            | December 31,<br>2011 | December 31,<br>2010 |
|----------------------------|----------------------|----------------------|
| <b>Total assets:</b>       |                      |                      |
| North America              | \$ 688,001           | \$ 576,139           |
| International              | 422,246              | 338,685              |
| Inter-segment eliminations | (281,607)            | (198,821)            |

|  |    |         |    |         |
|--|----|---------|----|---------|
|  | \$ | 828,640 | \$ | 716,003 |
|--|----|---------|----|---------|

The following table summarizes Long-lived assets by segment:

|               | December 31, |         | December 31, |         |
|---------------|--------------|---------|--------------|---------|
|               | 2011         |         | 2010         |         |
| North America | \$           | 378,267 | \$           | 383,420 |
| International |              | 61,999  |              | 57,600  |
|               | \$           | 440,266 | \$           | 441,020 |

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The following table summarizes segment information:

|   | Year Ended December 31, |              |            |
|---|-------------------------|--------------|------------|
|   | 2011                    | 2010         | 2009       |
| <b>Net sales from external customers:</b>   |                         |              |            |
| <b>North America</b>  |                         |              |            |
| Mattresses  | \$ 693,407              | \$ 539,199   | \$ 366,925 |
| Pillows   | 75,569                  | 65,728       | 48,814     |
| Other   | 235,759                 | 167,099      | 109,585    |
|   | \$ 1,004,735            | \$ 772,026   | \$ 525,324 |
| <b>International</b>  |                         |              |            |
| Mattresses  | \$ 250,942              | \$ 196,400   | \$ 183,022 |
| Pillows   | 76,119                  | 64,839       | 58,718     |
| Other   | 86,142                  | 72,156       | 64,092     |
|   | \$ 413,203              | \$ 333,395   | \$ 305,832 |
|   | \$ 1,417,938            | \$ 1,105,421 | \$ 831,156 |
| <b>Inter-segment sales:</b>   |                         |              |            |
| North America   | \$ 4,958                | \$ 357       | \$ —       |
| International   | 2,236                   | 2,397        | 2,502      |
| Inter-segment eliminations  | (7,194)                 | (2,754)      | (2,502)    |
|   | \$ —                    | \$ —         | \$ —       |
| <b>Gross profit:</b>  |                         |              |            |
| North America   | \$ 499,808              | \$ 358,306   | \$ 222,572 |
| International   | 243,282                 | 197,121      | 171,170    |
|   | \$ 743,090              | \$ 555,427   | \$ 393,742 |
| <b>Operating income:</b>  |                         |              |            |
| North America   | \$ 236,853              | \$ 152,833   | \$ 64,487  |
| International   | 103,678                 | 93,069       | 80,458     |
|   | \$ 340,531              | \$ 245,902   | \$ 144,945 |
| <b>Income before income taxes:</b>  |                         |              |            |
| North America   | \$ 224,605              | \$ 137,697   | \$ 49,703  |
| International   | 103,786                 | 93,168       | 78,334     |
|   | \$ 328,391              | \$ 230,865   | \$ 128,037 |
| <b>Depreciation and amortization (including stock-based compensation amortization):</b> |                         |              |            |
| North America   | \$ 41,111               | \$ 34,881    | \$ 30,331  |
| International   | 9,877                   | 9,088        | 9,882      |
|   | \$ 50,988               | \$ 43,969    | \$ 40,213  |
| <b>Capital expenditures:</b>  |                         |              |            |

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|               |    |        |    |        |    |        |
|---------------|----|--------|----|--------|----|--------|
| North America | \$ | 18,793 | \$ | 11,038 | \$ | 8,067  |
| International |    | 10,673 |    | 7,103  |    | 6,236  |
|               | \$ | 29,466 | \$ | 18,141 | \$ | 14,303 |

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

## (16) Quarterly Financial Data (unaudited)

The Company's quarterly operating results fluctuate as a result of seasonal variations in the Company's business.

Quarterly results of operations for the years ended December 31, 2011 and 2010 are summarized below:

|                                   | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|-----------------------------------|------------------|-------------------|------------------|-------------------|
| 2011                              |                  |                   |                  |                   |
| Net sales                         | \$ 325,838       | \$ 342,212        | \$ 383,085       | \$ 366,803        |
| Gross profit                      | 170,310          | 181,018           | 200,594          | 191,168           |
| Operating income                  | 75,280           | 82,830            | 96,607           | 85,814            |
| Net income                        | 48,260           | 53,084            | 61,949           | 56,315            |
| Basic earnings per common share   | \$ 0.70          | \$ 0.78           | \$ 0.93          | \$ 0.86           |
| Diluted earnings per common share | \$ 0.68          | \$ 0.76           | \$ 0.90          | \$ 0.84           |
| 2010                              |                  |                   |                  |                   |
| Net sales                         | \$ 253,889       | \$ 263,044        | \$ 295,785       | \$ 292,703        |
| Gross profit                      | 124,809          | 128,041           | 150,754          | 151,823           |
| Operating income                  | 52,290           | 53,850            | 68,154           | 71,608            |
| Net income                        | 33,148           | 33,506            | 44,198           | 46,292            |
| Basic earnings per common share   | \$ 0.45          | \$ 0.47           | \$ 0.64          | \$ 0.68           |
| Diluted earnings per common share | \$ 0.44          | \$ 0.46           | \$ 0.62          | \$ 0.66           |

The sum of the quarterly earnings per common share amounts may not equal the annual amount reported because per share amounts are computed independently for each quarter and for the full year based on respective weighted-average common shares outstanding and other dilutive potential common shares. The Company's quarterly operating results fluctuate as a result of seasonal variations in the Company's business.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES  
VALUATION AND QUALIFYING ACCOUNTS  
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011  
SCHEDULE II

| Description                             | Balance at<br>Beginning of<br>Period | Additions<br>Charges to<br>Costs and<br>Expenses | Charged to<br>Other<br>Accounts | Deductions  | Balance at<br>End of Period |
|---|--------------------------------------|--|---------------------------------|-------------|-----------------------------|
| <b>Allowance for Doubtful Accounts:</b> |                                      |  |                                 |             |                             |
| Year Ended December 31, 2009            | \$ 6,726                             | \$ 5,936   | \$ —                            | —\$ (3,632) | \$ 9,030                    |
| Year Ended December 31, 2010            | \$ 9,030                             | \$ 531   | \$ —                            | —\$ (2,124) | \$ 7,437                    |
| Year Ended December 31, 2011            | \$ 7,437                             | \$ 1,563   | \$ —                            | —\$ (2,199) | \$ 6,801                    |

| Description   | Balance at<br>Beginning of<br>Period | Additions<br>Charges to<br>Costs and<br>Expenses | Charged to<br>Other<br>Accounts | Deductions  | Balance at<br>End of Period |
|---|--------------------------------------|--|---------------------------------|-------------|-----------------------------|
| <b>Valuation allowance deferred tax<br/>assets:</b> |                                      |  |                                 |             |                             |
| Year Ended December 31, 2009                        | \$ 8,736                             | \$ 1,037   | \$ —                            | —\$ —       | \$ 9,773                    |
| Year Ended December 31, 2010                        | \$ 9,773                             | \$ —   | \$ —                            | —\$ (957)   | \$ 8,816                    |
| Year Ended December 31, 2011                        | \$ 8,816                             | \$ —   | \$ —                            | —\$ (5,879) | \$ 2,937                    |

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