

TEMPUR SEALY INTERNATIONAL, INC.  
Form 10-Q  
August 03, 2017  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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

For the transition period from  
to

Commission file number 001-31922

TEMPUR SEALY INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware

33-1022198

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1000 Tempur Way

Lexington, Kentucky 40511

(Address, including zip code, of principal executive offices)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

|  |   |  |   |  |
|--|---|--|---|--|
| Large accelerated<br>filer <input checked="" type="checkbox"/> | Accelerated<br>filer <input type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> | Smaller reporting<br>company <input type="checkbox"/> | Emerging<br>Growth<br>Company <input type="checkbox"/> |
|--|---|--|---|--|

(Do not check if a smaller reporting company)

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

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

The number of shares outstanding of the registrant's common stock as of July 31, 2017 was 53,973,796 shares.

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Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including the information incorporated by reference herein, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which includes information concerning one or more of our plans; objectives; goals; strategies; future events; future revenues or performance; our implementation of our key strategic priorities and anticipated resulting growth in our sales, earnings and cash flow in both the United States and internationally on our business segments; uncertainties arising from global events; general economic, financial and industry conditions, particularly in the retail sector, as well as consumer confidence and the availability of consumer financing; competition in our industry; consumer acceptance of our products; the ability to continuously improve and expand our product line, maintain efficient, timely and cost-effective production and delivery of products, and manage growth; the ability to expand brand awareness, distribution and new products; the efficiency and effectiveness of our advertising campaigns and other marketing programs; the ability to increase sales productivity within existing retail accounts and to further penetrate the wholesale channel, including the timing of opening or expanding within large retail accounts and the timing and success of product launches; the effects of consolidation of retailers on revenues and costs; changes in demand for the Company's products by significant retailer customers; the effects of strategic investments on our operations, including our efforts to expand our global market share; changing commodity costs; changes in product and channel mix and the impact on the Company's gross margin; initiatives to improve gross margin and operating margin; our capital structure and increased debt level, including our ability to meet financial obligations and continue to comply with the terms and financial ratio covenants of our credit facilities; changes in interest rates; changes in foreign tax rates and changes in tax laws generally, including the ability to utilize tax loss carry forwards; effects of changes in foreign exchange rates on our reported earnings; the outcome of pending tax audits or other tax, regulatory or litigation proceedings and similar issues; the effect of future legislative or regulatory changes; financial flexibility; our expected sources of cash flow; our expected level of capital expenditures for 2017 and changes in capital expenditures; expectations regarding the impact of costs from headcount reductions and international store closures; and our ability to effectively manage cash. Many of these statements appear, in particular, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in ITEM 2 of Part I of this Report. When used in this report, the words "estimates," "expects," "guidance," "anticipates," "proposed," "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, uncertainties and other important factors, many of which are beyond the Company's control, that could cause our actual results to differ materially from those expressed as forward-looking statements in this report, including the risk factors discussed under the heading "Risk Factors" under ITEM 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2016 and the risks identified in ITEM 1A 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 Sealy International" refers to Tempur Sealy International, Inc. only, and the terms "Company," "we," "our," "ours" and "us" refer to Tempur Sealy International, Inc. and its consolidated subsidiaries. When used in this Report, the term "Sealy" refers to Sealy Corporation and its historical subsidiaries. In addition, when used in this Report "2016 Credit Agreement" refers to the

Company's senior credit facility entered into in the first quarter of 2016; "2012 Credit Agreement" refers to the Company's prior senior credit facility entered into in 2012; "2026 Senior Notes" refers to the 5.50% senior notes due 2026 issued in 2016; and "2023 Senior Notes" refers to the 5.625% senior notes due 2023 issued in 2015.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(\$ in millions, except per common share amounts)

(unaudited)

|   | Three Months Ended |         | Six Months Ended |           |
|---|--------------------|---------|------------------|-----------|
|   | June 30,           |         | June 30,         |           |
|   | 2017               | 2016    | 2017             | 2016      |
| Net sales   | \$659.3            | \$804.4 | \$1,381.4        | \$1,525.4 |
| Cost of sales   | 390.7              | 467.5   | 826.2            | 897.5     |
| Gross profit  | 268.6              | 336.9   | 555.2            | 627.9     |
| Selling and marketing expenses                              | 152.3              | 172.8   | 306.0            | 322.9     |
| General, administrative and other expenses                  | 69.0               | 71.9    | 135.5            | 143.6     |
| Customer termination charges, net                           | —                  | —       | 14.4             | —         |
| Equity income in earnings of unconsolidated affiliates      | (4.4 )             | (3.4 )  | (7.1 )           | (6.2 )    |
| Royalty income, net of royalty expense                      | (4.9 )             | (4.6 )  | (9.7 )           | (9.3 )    |
| Operating income  | 56.6               | 100.2   | 116.1            | 176.9     |
| Other expense, net:   |                    |         |                  |           |
| Interest expense, net                                       | 22.1               | 23.1    | 44.2             | 44.5      |
| Loss on extinguishment of debt                              | —                  | 47.2    | —                | 47.2      |
| Other (income) expense, net                                 | (0.3 )             | 0.7     | (9.5 )           | (0.3 )    |
| Total other expense, net                                    | 21.8               | 71.0    | 34.7             | 91.4      |
| Income before income taxes                                  | 34.8               | 29.2    | 81.4             | 85.5      |
| Income tax provision  | (13.1 )            | (9.2 )  | (27.7 )          | (26.5 )   |
| Net income before non-controlling interests                 | 21.7               | 20.0    | 53.7             | 59.0      |
| Less: Net loss attributable to non-controlling interests    | (2.8 )             | (1.3 )  | (4.7 )           | (1.9 )    |
| Net income attributable to Tempur Sealy International, Inc. | \$24.5             | \$21.3  | \$58.4           | \$60.9    |
| Earnings per common share:                                  |                    |         |                  |           |
| Basic   | \$0.45             | \$0.35  | \$1.08           | \$1.00    |
| Diluted   | \$0.45             | \$0.35  | \$1.07           | \$0.99    |
| Weighted average common shares outstanding:                 |                    |         |                  |           |
| Basic   | 53.9               | 60.2    | 53.9             | 61.1      |
| Diluted   | 54.5               | 60.8    | 54.6             | 61.7      |

See accompanying Notes to Condensed Consolidated Financial Statements.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ in millions)

(unaudited)

|   | Three Months |        | Six Months |        |
|---|--------------|--------|------------|--------|
|   | Ended        |        | Ended      |        |
|   | June 30,     |        | June 30,   |        |
|   | 2017         | 2016   | 2017       | 2016   |
| Net income before non-controlling interests                           | \$21.7       | \$20.0 | \$53.7     | \$59.0 |
| Other comprehensive income (loss), net of tax                         |              |        |            |        |
| Foreign currency translation adjustments                              | 9.3          | (2.3 ) | 18.1       | 16.8   |
| Unrealized loss on cash flow hedging derivatives, net of tax          | (0.1 )       | (1.0 ) | (0.6 )     | (5.9 ) |
| Other comprehensive income (loss), net of tax                         | 9.2          | (3.3 ) | 17.5       | 10.9   |
| Comprehensive income  | 30.9         | 16.7   | 71.2       | 69.9   |
| Less: Comprehensive loss attributable to non-controlling interests    | (2.8 )       | (1.3 ) | (4.7 )     | (1.9 ) |
| Comprehensive income attributable to Tempur Sealy International, Inc. | \$33.7       | \$18.0 | \$75.9     | \$71.8 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(\$ in millions)

|   | June 30, 2017<br>(Unaudited) | December 31, 2016 |
|---|------------------------------|-------------------|
| <b>ASSETS</b>   |                              |                   |
| Current Assets:                                       |                              |                   |
| Cash and cash equivalents                             | \$ 38.5                      | \$ 65.7           |
| Accounts receivable, net                              | 356.2                        | 345.1             |
| Inventories   | 194.5                        | 196.8             |
| Prepaid expenses and other current assets             | 58.4                         | 63.9              |
| Total Current Assets                                  | 647.6                        | 671.5             |
| Property, plant and equipment, net                    | 424.8                        | 422.2             |
| Goodwill  | 727.6                        | 722.5             |
| Other intangible assets, net                          | 672.9                        | 678.7             |
| Deferred income taxes                                 | 25.5                         | 22.5              |
| Other non-current assets                              | 212.8                        | 185.2             |
| Total Assets  | \$ 2,711.2                   | \$ 2,702.6        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b> |                              |                   |
| Current Liabilities:                                  |                              |                   |
| Accounts payable                                      | \$ 231.8                     | \$ 219.3          |
| Accrued expenses and other current liabilities        | 227.5                        | 250.1             |
| Income taxes payable                                  | 9.9                          | 5.8               |
| Current portion of long-term debt                     | 68.4                         | 70.3              |
| Total Current Liabilities                             | 537.6                        | 545.5             |
| Long-term debt, net                                   | 1,793.2                      | 1,817.8           |
| Deferred income taxes                                 | 163.3                        | 174.6             |
| Other non-current liabilities                         | 190.0                        | 169.3             |
| Total Liabilities                                     | 2,684.1                      | 2,707.2           |
| Commitments and contingencies—see Note 8              |                              |                   |
| Redeemable non-controlling interest                   | 5.3                          | 7.6               |
| Total Stockholders' Equity (Deficit)                  | 21.8                         | (12.2 )           |
| Total Liabilities, Redeemable                         | \$ 2,711.2                   | \$ 2,702.6        |



Non-Controlling Interest and  
Stockholders' Equity  
(Deficit)

See accompanying Notes to Condensed Consolidated Financial Statements.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ in millions)

(unaudited)

|   | Six Months<br>Ended<br>June 30, |           |
|---|---------------------------------|-----------|
|   | 2017                            | 2016      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                 |           |
| Net income before non-controlling interests                                       | \$53.7                          | \$59.0    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Depreciation and amortization   | 39.7                            | 36.0      |
| Amortization of stock-based compensation  | 2.6                             | 10.6      |
| Amortization of deferred financing costs  | 1.1                             | 2.5       |
| Bad debt expense  | 6.0                             | 1.8       |
| Deferred income taxes   | (13.4)                          | (0.9)     |
| Dividends received from unconsolidated affiliates                                 | 3.5                             | 3.6       |
| Equity income in earnings of unconsolidated affiliates                            | (7.1)                           | (6.2)     |
| Non-cash interest expense on 8.0% Sealy Notes                                     | —                               | 3.6       |
| Loss on extinguishment of debt  | —                               | 47.2      |
| (Gain) loss on sale of assets   | (1.3)                           | 0.5       |
| Foreign currency adjustments and other  | 0.7                             | (1.2)     |
| Changes in operating assets and liabilities                                       | (10.3)                          | (104.6)   |
| Net cash provided by operating activities   | 75.2                            | 51.9      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                 |           |
| Purchases of property, plant and equipment  | (25.9)                          | (24.3)    |
| Other   | 0.9                             | —         |
| Net cash used in investing activities   | (25.0)                          | (24.3)    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                                 |           |
| Proceeds from borrowings under long-term debt obligations                         | 718.9                           | 1,435.3   |
| Repayments of borrowings under long-term debt obligations                         | (745.9)                         | (1,230.4) |
| Proceeds from exercise of stock options   | 1.9                             | 6.0       |
| Excess tax benefit from stock-based compensation                                  | —                               | 3.0       |
| Treasury stock repurchased  | (44.1)                          | (217.3)   |
| Payments of deferred financing costs  | (0.4)                           | (6.2)     |
| Fees paid to lenders  | —                               | (7.8)     |
| Call premium on 2020 Senior Notes   | —                               | (23.6)    |
| Other   | (2.7)                           | 0.4       |
| Net cash used in financing activities   | (72.3)                          | (40.6)    |
| NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS                  | (5.1)                           | (3.0)     |
| Decrease in cash and cash equivalents   | (27.2)                          | (16.0)    |
| CASH AND CASH EQUIVALENTS, beginning of period                                    | 65.7                            | 153.9     |
| CASH AND CASH EQUIVALENTS, end of period  | \$38.5                          | \$137.9   |

## Supplemental cash flow information:

Cash paid during the period for:

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|                              |        |        |
|------------------------------|--------|--------|
| Interest                     | \$43.0 | \$36.5 |
| Income taxes, net of refunds | 37.1   | 40.4   |

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited)

(1) Summary of Significant Accounting Policies

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

The Company develops, manufactures, markets and sells bedding products, which include mattresses, foundations and adjustable bases, and other products, which include pillows and other accessories. The Company also derives income from royalties by licensing Sealy® and Stearns & Foster® brands, technology and trademarks to other manufacturers. The Company sells its products through two sales channels: Wholesale and Direct.

The Company's Condensed Consolidated Financial Statements include the results of Comfort Revolution, LLC ("Comfort Revolution"), a 45.0% owned joint venture. Comfort Revolution constitutes a variable interest entity for which the Company is considered to be the primary beneficiary due to the Company's disproportionate share of the economic risk associated with its equity contribution, debt financing and other factors. The operations of Comfort Revolution are not material to the Company's Condensed Consolidated Financial Statements.

The Company also has ownership interests in a group of Asia-Pacific joint ventures to develop markets for Sealy® branded products in those regions. The Company's ownership interest in these joint ventures is 50.0%. The equity method of accounting is used for these joint ventures, over which the Company has significant influence but does not have control, and consolidation is not otherwise required. The Company's carrying value in its equity method investments of \$20.1 million and \$15.5 million at June 30, 2017 and December 31, 2016, respectively, is recorded in other non-current assets within the accompanying Condensed Consolidated Balance Sheets. The Company's equity in the net income and losses of these investments is recorded as equity income in earnings of unconsolidated affiliates in the accompanying Condensed Consolidated Statements of Income.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States ("U.S. GAAP" or "GAAP") for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Company and related footnotes for the year ended December 31, 2016, included in the Company's Annual Report on Form 10-K filed on February 24, 2017.

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

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

|                 | June     | December |
|-----------------|----------|----------|
|                 | 30,      | 31,      |
| (in millions)   | 2017     | 2016     |
| Finished goods  | \$ 133.1 | \$ 130.1 |
| Work-in-process | 10.4     | 10.7     |

|                            |         |          |
|----------------------------|---------|----------|
| Raw materials and supplies | 51.0    | 56.0     |
|                            | \$194.5 | \$ 196.8 |

(c) Accrued Sales Returns. The Company allows product returns 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. Estimated future obligations related to these products are provided by a reduction of sales in the period in which the revenue is recognized. Accrued sales returns are included in accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

The Company had the following activity for sales returns from December 31, 2016 to June 30, 2017:  
(in millions)

|                                 |         |
|---------------------------------|---------|
| Balance as of December 31, 2016 | \$30.3  |
| Amounts accrued                 | 61.7    |
| Returns charged to accrual      | (59.3 ) |
| Balance as of June 30, 2017     | \$32.7  |

(d) Warranties. The Company provides warranties on certain products, which vary by segment, product and brand. Estimates of warranty expenses are based primarily on historical claims experience and product testing. Estimated future obligations related to these products are charged to cost of sales in the period in which the related revenue is recognized. The Company considers the impact of recoverable salvage value on warranty costs in determining its estimate of future warranty obligations.

The Company provides warranties on mattresses with varying warranty terms. Tempur mattresses sold in the North America segment and all Sealy mattresses have warranty terms ranging from 10 to 25 years, generally non-prorated for the first 10 to 15 years and then prorated for the balance of the warranty term. Tempur mattresses sold in the International segment have warranty terms ranging from 5 to 15 years, non-prorated for the first 5 years and then prorated on a straight-line basis for the last 10 years of the warranty term. Tempur pillows have a warranty term of 3 years, non-prorated.

The Company had the following activity for its accrued warranty expense from December 31, 2016 to June 30, 2017:  
(in millions)

|                                 |         |
|---------------------------------|---------|
| Balance as of December 31, 2016 | \$29.9  |
| Amounts accrued                 | 23.0    |
| Warranties charged to accrual   | (13.6 ) |
| Balance as of June 30, 2017     | \$39.3  |

As of June 30, 2017 and December 31, 2016, \$19.3 million and \$14.3 million of accrued warranty expense is included as a component of accrued expenses and other current liabilities and \$20.0 million and \$15.6 million of accrued warranty expense is included in other non-current liabilities on the Company's accompanying Condensed Consolidated Balance Sheets, respectively.

(e) Revenue Recognition. Sales of products are recognized when persuasive evidence of an arrangement exists, 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, as well as promotional allowances, floor sample discounts, commissions paid to retail associates and slotting fees, and reflects these amounts as a reduction of sales at the time revenue is recognized based on historical experience. 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 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 customer receivable is reasonably assured. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the

potential for recovery is considered remote. The allowance for doubtful accounts included in accounts receivable, net in the accompanying Condensed Consolidated Balance Sheets was \$23.5 million and \$22.1 million as of June 30, 2017 and December 31, 2016, respectively.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

(f) Derivative Financial Instruments. Derivative financial instruments are used in the normal course of business to manage interest rate and foreign currency exchange risks. 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. For all transactions designated as hedges, the hedging relationships are formally documented at the inception and on an ongoing basis in offsetting changes in cash flows of the hedged transaction.

The Company records derivative financial instruments on the Condensed Consolidated Balance Sheets as either an asset or liability measured at its fair value. Changes in a derivative's fair value (i.e. unrealized gains or losses) are recorded each period in earnings or other comprehensive income, depending on whether the derivative is designated and is effective as a hedged transaction, and on the type of hedging relationship.

For derivative financial instruments that are designated as a hedge, unrealized gains and losses related to the effective portion are either recognized in income immediately to offset the realized gain or loss on the hedged item, or are deferred and reported as a component of accumulated other comprehensive loss (“AOCL”) 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 derivative financial instrument is recognized in net income immediately. For derivative instruments that are not designated as hedges, the gain or loss related to the change in fair value is also recorded in net income immediately.

The Company manages a portion of the risk associated with fluctuations in foreign currencies related to intercompany and third party inventory purchases denominated in foreign currencies through foreign exchange forward contracts designated as cash flow hedges. As of June 30, 2017, the Company had foreign exchange forward contracts designated as cash flow hedges to buy U.S. dollars and to sell Canadian dollars with a notional amount outstanding of \$4.7 million. These foreign exchange forward contracts have maturities ranging from July 2017 to September 2017. The effectiveness of the cash flow hedge contracts, including time value, is assessed prospectively and retrospectively on a monthly basis using regression analysis, as well as other timing and probability criteria. The Company expects to reclassify a loss of approximately \$0.1 million, net of tax, over the next three months based on June 30, 2017 exchange rates.

The Company is also exposed to foreign currency risk related to intercompany debt and associated interest payments and certain intercompany accounts receivable and accounts payable. To manage the risk associated with fluctuations in foreign currencies related to these assets and liabilities, the Company enters into foreign exchange forward contracts. The Company considers these contracts to be economic hedges. Accordingly, changes in the fair value of these instruments affect earnings during the current period. These foreign exchange forward contracts protect against the reduction in value of forecasted foreign currency cash flows resulting from payments in foreign currencies.

The fair value of the Company's financial instruments that are recorded on a recurring basis at fair value is not material.

(g) 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 any such change is enacted. 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.

(h) Customer Contract Termination. During the week of January 23, 2017, the Company was unexpectedly notified by the senior management of Mattress Firm, Inc. ("Mattress Firm") and representatives of Steinhoff International Holdings Ltd. ("Steinhoff"), its parent company, of Mattress Firm's intent to terminate its business relationship with the Company if the Company did not agree to considerable changes to its agreements with Mattress Firm, including significant economic concessions. The Company engaged in discussions to facilitate a mutually agreeable supply arrangement with Mattress Firm. However, the parties were unable to reach an agreement, and on January 27, 2017, Tempur-Pedic North America, LLC ("Tempur-Pedic") and Sealy Mattress Company ("Sealy Mattress") issued formal termination notices for all of their products to Mattress Firm. On January 30, 2017, Tempur-Pedic and Sealy Mattress entered into transition agreements with Mattress Firm in which they agreed, among other things, to continue supplying Mattress Firm until April 3, 2017, at which time the parties' business relationship ended.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

In the first quarter of 2017, the Company took steps to manage its cost structure as a result of the termination of the contracts with Mattress Firm. For the three months ended March 31, 2017, the Company recognized \$25.9 million of net charges associated with the termination of the relationship with Mattress Firm. This amount includes \$11.5 million of charges within cost of sales and \$14.4 million of charges within customer termination charges, net on the Condensed Consolidated Statements of Income for the three months ended March 31, 2017. The following amounts are recognized in cost of sales: \$5.4 million of charges related to the write-off of customer-unique inventory and \$6.1 million of increased warranty costs associated with claims historically retained by Mattress Firm. The following amounts are recognized in customer termination charges, net: \$22.8 million of charges related to the write-off of Mattress Firm incentives and marketing assets, employee-related expenses and professional fees; and \$0.9 million of accelerated stock-based compensation expense. These charges are offset by \$9.3 million of benefit related to the change in estimate associated with performance-based stock compensation that is no longer probable of payout as a result of the termination of the contracts with Mattress Firm.

In the three months ended March 31, 2017, the Company also recognized \$9.3 million related to the payments received pursuant to the transition agreements with Mattress Firm. This amount is included within other income, net on the Condensed Consolidated Statements of Income.

The termination of the Mattress Firm relationship was identified by the Company as an indicator of potential impairment. The Company conducted an interim impairment analysis as of March 31, 2017 of its North America reporting unit and indefinite-lived intangible assets, which indicated that the fair values were substantially in excess of their carrying values. The Company also conducted a recoverability analysis of its long-lived assets and did not identify an impairment.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

(2) Recently Issued Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue From Contracts With Customers, that outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This ASU is based on the core principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The new standard is effective for the Company on January 1, 2018 and the Company will be using the modified retrospective method of adoption.

The Company has conducted a risk assessment and has developed a transition plan that will enable the Company to meet the implementation requirement. Revenue streams and performance obligations include product sales, sales-based royalties and warranties. The Company's contracts also include forms of variable consideration, including rebates (volume, cash and cooperative advertising), trade or other support, free products, slotting fees, and sales returns. Based on the evaluation of the Company's current contracts and the related revenue streams and performance obligations, most will be recorded consistently under both the current and new standard. The majority of the Company's revenue transactions are not accounted for under industry-specific guidance that will be superseded by ASC 606 and generally consist of a single performance obligation to transfer promised goods.

Upon adoption of ASC 606, the Company expects the largest impacts to result from the new qualitative and quantitative disclosures that will be required upon adoption of the new standard. Other anticipated presentation and disclosure changes include the reclassification of royalty income to revenue and changes in the balance sheet classification for sales returns. Under the new standard, the Company will continue to recognize the amount of consideration received or receivable that is expected to be returned as a refund liability, representing the Company's obligation to return the customer's consideration. The Company will also recognize a return asset (and adjust cost of sales) for the right to recover the goods returned by the customer, which will be subject to impairment assessments. The Company continues to evaluate the impact of the adoption on the classification of cooperative advertising programs and other promotional programs with the Company's customers. The impact of adoption to these promotional programs are not anticipated to impact the timing or recognition of costs, but could result in material changes in the Company's presentation of costs within the Company's consolidated statements of comprehensive income.

Leases

In February 2016, the FASB issued ASU No. 2016-02, Leases, that requires lessees to recognize most leases on the balance sheet and provides for expanded disclosures on key information about leasing arrangements. This ASU is effective for interim and annual periods beginning after December 15, 2018, however early adoption is permitted. In transition, entities are required to use a modified retrospective approach for the adoption of this ASU. The Company is currently evaluating this ASU to determine the impact it will have on the Company's Condensed Consolidated Financial Statements.

### Employee Share-Based Payments

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and the classification on the statement of cash flows. The Company adopted this ASU as of January 1, 2017. As a result of the adoption of this ASU, the Company implemented the following simplification initiatives in the Condensed Consolidated Financial Statements:

The Company recognized all excess tax benefits and tax deficiencies as income tax expense or benefit in the Condensed Consolidated Statement of Income. The Company recognized excess tax deficiencies of \$0.1 million and \$1.1 million in the three and six months ended June 30, 2017, respectively.

The Company is prospectively presenting these excess tax benefits and tax deficiencies as an operating activity on the Condensed Consolidated Statement of Cash Flows.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

The Company adopted a change in accounting policy to recognize forfeitures of awards as they occur instead of estimating potential forfeitures. Historically, the Company estimated the number of awards expected to be forfeited and adjusted the estimate when it was no longer probable that employees would fulfill their service conditions. The effect of this change in accounting policy is not material.

## Pensions

In March 2017, the FASB issued ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which is accounting guidance that will change how employers who sponsor defined benefit pension and/or postretirement benefit plans present the net periodic benefit cost in the Condensed Consolidated Statements of Income. This guidance requires employers to present the service cost component of net periodic benefit cost in the same caption within the Condensed Consolidated Statements of Income as other employee compensation costs from services rendered during the period. All other components of the net periodic benefit cost will be presented separately outside of the operating income caption. This guidance must be applied retrospectively and will become effective for the Company on January 1, 2018. The Company expects this guidance will result in a reclassification of pension and other postretirement plan non-service income and remeasurement adjustments, net from within operating income to non-operating income.

## (3) Goodwill

The following summarizes changes to the Company's goodwill, by segment:

| (in millions)                   | North<br>America | International | Consolidated |
|---------------------------------|------------------|---------------|--------------|
| Balance as of December 31, 2016 | \$ 572.0         | \$ 150.5      | \$ 722.5     |
| Foreign currency translation    | 2.3              | 2.8           | 5.1          |
| Balance as of June 30, 2017     | \$ 574.3         | \$ 153.3      | \$ 727.6     |

## (4) Debt

Debt for the Company consists of the following:

| (in millions, except percentages)        | June 30, 2017 |        | December 31, 2016 |        | Maturity Date    |
|--|---------------|--------|-------------------|--------|------------------|
|  | Amount        | Rate   | Amount            | Rate   |                  |
| 2016 Credit Agreement                    |               |        |                   |        |                  |
| Term A Facility                          | \$570.0       | (1)    | \$585.0           | (1)    | April 6, 2021    |
| Revolver                                 | 87.0          | (1)    | 156.9             | (1)    | April 6, 2021    |
| 2026 Senior Notes                        | 600.0         | 5.500% | 600.0             | 5.500% | June 15, 2026    |
| 2023 Senior Notes                        | 450.0         | 5.625% | 450.0             | 5.625% | October 15, 2023 |
| Securitized debt                         | 60.1          | (3)    | —                 | N/A    | April 12, 2019   |
| Capital lease obligations <sup>(2)</sup> | 73.5          |        | 73.3              |        | Various          |
| Other                                    | 33.2          |        | 35.8              |        | Various          |
| Total debt                               | 1,873.8       |        | 1,901.0           |        |                  |
| Less: deferred financing costs           | (12.2 )       |        | (12.9 )           |        |                  |
| Total debt, net                          | 1,861.6       |        | 1,888.1           |        |                  |
| Less: current portion                    | (68.4 )       |        | (70.3 )           |        |                  |
| Total long-term debt, net                | \$1,793.2     |        | \$1,817.8         |        |                  |

(1) Interest at LIBOR plus applicable margin of 1.50% as of June 30, 2017 and December 31, 2016.

(2) Capital lease obligations are a non-cash financing activity.

(3) Interest at one month LIBOR index plus 80 basis points.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

2016 Credit Agreement

On April 6, 2016, the Company entered into a senior secured credit agreement ("2016 Credit Agreement") with a syndicate of banks. The 2016 Credit Agreement replaced the Company's 2012 Senior Secured Credit Agreement.

The 2016 Credit Agreement requires compliance with certain financial covenants providing for maintenance of a minimum consolidated interest coverage ratio, maintenance of a maximum consolidated total net leverage ratio, and maintenance of a maximum consolidated secured net leverage ratio. The consolidated total net leverage ratio is calculated using consolidated funded debt less qualified cash. Consolidated funded debt includes debt recorded on the Condensed Consolidated Balance Sheets as of the reporting date, plus letters of credit outstanding and other short-term debt. The Company is allowed to subtract from consolidated funded debt an amount equal to 100.0% of domestic qualified cash and 60.0% of foreign qualified cash, the aggregate of which cannot exceed \$150.0 million at the end of the reporting period. As of June 30, 2017, domestic qualified cash was \$14.9 million and foreign qualified cash was \$14.1 million.

The Company is in compliance with all applicable covenants as of June 30, 2017.

Securitized Debt

On April 12, 2017, the Company and certain of its subsidiaries entered into a securitization transaction with respect to certain accounts receivable due to the Company and certain of its subsidiaries (the "Accounts Receivable Securitization"). In connection with this transaction, the Company and its wholly-owned special purpose subsidiary, Tempur Sealy Receivables, LLC, entered into a credit agreement that provides for revolving loans to be made from time to time in a maximum amount that varies over the course of the year based on seasonality subject to an overall limit of \$120.0 million. The revolving loans will bear interest at a floating rate equal to a one month LIBOR index plus 80 basis points.

The obligations of the Company under the Accounts Receivable Securitization are secured by the accounts receivable and certain related rights and contain customary events of default. The accounts receivable will continue to be owned by the Company and its subsidiaries and will continue to be reflected as assets on the Company's Condensed Consolidated Balance Sheets and represent collateral up to the amount of the borrowings under this facility. Borrowings under this facility will be classified as long-term debt within the Condensed Consolidated Balance Sheets.

Fair Value of Financial Instruments

Financial instruments, although not recorded at fair value on a recurring basis, include cash and cash equivalents, accounts receivable, accounts payable, and the Company's debt obligations. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value using Level 1 inputs because of the short-term maturity of those instruments. Borrowings under the 2016 Credit Agreement and the securitized debt are at variable interest rates and accordingly their carrying amounts approximate fair value. The fair value of the following material financial instruments were based on Level 2 inputs estimated using discounted cash flows and market-based expectations for interest rates, credit risk, and the contractual terms of debt instruments. The fair values of these material financial instruments are as follows:

|               | Fair Value    |                   |
|---------------|---------------|-------------------|
| (in millions) | June 30, 2017 | December 31, 2016 |
|               |               |                   |

2023 Senior Notes \$468.1 \$ 468.5

2026 Senior Notes 610.2 606.8



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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

(5) Stockholder's Equity

(a) Common Stock. Tempur Sealy International has 300.0 million authorized shares of common stock with \$0.01 per share par value and 0.01 million authorized shares of preferred stock with \$0.01 per share par value. 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 the common stock are entitled to receive ratably such dividends as may be declared from time to time by the Board of Directors ("Board") out of funds legally available for that purpose. In the event of liquidation, dissolution or winding up, the holders of the common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred stock, if any, then outstanding.

The Board 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, which may include, among others, dividend rights, voting rights, redemption and sinking fund provisions, liquidation preferences, conversion rights and preemptive rights.

(b) Treasury Stock. In February 2017, the Board authorized an increase of \$200.0 million to its existing share repurchase authorization for repurchases of Tempur Sealy International's common stock. For the six months ended June 30, 2017, the Company repurchased 0.6 million shares for approximately \$40.1 million. As of June 30, 2017, the Company had approximately \$226.9 million remaining under the existing share repurchase authorization.

In addition, the Company acquired 0.1 million shares upon the vesting of certain performance restricted stock units ("PRsUs"), which were withheld to satisfy tax withholding obligations during each of the six months ended June 30, 2017 and 2016. The shares withheld were valued at the closing price of the common stock on the New York Stock Exchange on the vesting date or first business day thereafter, resulting in approximately \$0.3 million and \$2.0 million in treasury stock acquired during the three months ended June 30, 2017 and 2016, respectively.

(c) Shareholder Rights Agreement. On February 8, 2017, the Board authorized and declared a dividend distribution of one right (a "Right") for each outstanding share of common stock, par value \$0.01 per share (the "Common Shares"), of the Company to stockholders of record at the close of business on February 20, 2017 (the "Record Date"). Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of Series A Junior Participating Preferred Stock, par value \$0.01 per share (the "Preferred Shares"), of the Company at an exercise price of \$90 per one one-thousandth of a Preferred Share, subject to adjustment (the "Exercise Price"). Generally, the Rights become exercisable in the event any person or group (including a group of persons that are acting in concert with each other) acquires 20% or more of the Common Shares without the approval of the Board, and until such time are inseparable from and trade with the Company's common stock. The Rights have a de minimis fair value. The Rights were issued pursuant to the Rights Agreement dated as of February 8, 2017 (the "Original Rights Agreement"), between the Company and American Stock Transfer & Trust Company, LLC ("AST"), the Company's rights agent. These Rights expire February 7, 2018 or upon an earlier redemption or exchange as provided in the Rights Agreement.

On March 14, 2017, the Company entered into an Amended and Restated Rights Agreement (the "Amended Rights Agreement") with AST, as rights agent, to amend certain provisions of the Original Rights Agreement. The primary purpose of the amendment and restatement of the Original Rights Agreement is to provide the holders of the Common Shares and the attached Rights issued under the Original Rights Agreement with the ability to exempt an offer to

acquire, or engage in another business combination transaction involving, the Company that is deemed a "Qualifying Offer" (as defined in the Amended and Restated Rights Agreement) from the terms of the Amended and Restated Rights Agreement. The Rights have a de minimis fair value as of June 30, 2017.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

(d) AOCL. AOCL consisted of the following:

| (in millions)   | Three Months Ended |           | Six Months Ended |            |
|---|--------------------|-----------|------------------|------------|
|   | June 30, 2017      | 2016      | June 30, 2017    | 2016       |
| Foreign Currency Translation  |                    |           |                  |            |
| Balance at beginning of period                                      | \$ (111.1)         | \$ (96.3) | \$ (119.9)       | \$ (115.4) |
| Other comprehensive income (loss):                                  |                    |           |                  |            |
| Foreign currency translation adjustments <sup>(1)</sup>             | 9.3                | (2.3 )    | 18.1             | 16.8       |
| Balance at end of period  | \$ (101.8)         | \$ (98.6) | \$ (101.8)       | \$ (98.6 ) |
| Pensions  |                    |           |                  |            |
| Balance at beginning of period                                      | \$ (2.2 )          | \$ (1.4 ) | \$ (2.2 )        | \$ (1.4 )  |
| Other comprehensive income (loss):                                  |                    |           |                  |            |
| Net change from period revaluations, net of tax                     | —                  | —         | —                | —          |
| Balance at end of period  | \$ (2.2 )          | \$ (1.4 ) | \$ (2.2 )        | \$ (1.4 )  |
| Foreign Exchange Forward Contracts                                  |                    |           |                  |            |
| Balance at beginning of period                                      | \$ 0.1             | \$ 1.7    | \$ 0.6           | \$ 6.6     |
| Other comprehensive loss:   |                    |           |                  |            |
| Net change from period revaluations                                 | (0.1 )             | (0.3 )    | (0.4 )           | (5.3 )     |
| Tax benefit <sup>(2)</sup>  | —                  | 0.1       | 0.1              | 1.4        |
| Total other comprehensive loss before reclassifications, net of tax | \$ (0.1 )          | \$ (0.2 ) | \$ (0.3 )        | \$ (3.9 )  |
| Net amount reclassified to earnings <sup>(3)</sup>                  | —                  | (1.1 )    | (0.4 )           | (2.7 )     |
| Tax benefit <sup>(2)</sup>  | —                  | 0.3       | 0.1              | 0.7        |
| Total amount reclassified from AOCL, net of tax                     | \$—                | \$ (0.8 ) | \$ (0.3 )        | \$ (2.0 )  |
| Total other comprehensive loss                                      | (0.1 )             | (1.0 )    | (0.6 )           | (5.9 )     |
| Balance at end of period  | \$—                | \$ 0.7    | \$—              | \$ 0.7     |

(1) In 2017 and 2016, there were no tax impacts related to foreign currency translation adjustments and no amounts were reclassified to earnings.

(2) These amounts were included in the income tax provision on the accompanying Condensed Consolidated Statements of Income.

(3) This amount was included in cost of sales on the accompanying Condensed Consolidated Statements of Income.

## (6) Other Items

Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following:

| (in millions)      | June 30, December 31, |         |
|--------------------|-----------------------|---------|
|                    | 2017                  | 2016    |
| Wages and benefits | \$ 45.0               | \$ 65.5 |
| Advertising        | 37.5                  | 48.6    |
| Sales returns      | 32.7                  | 30.3    |
| Warranty           | 19.3                  | 14.3    |

|         |          |          |
|---------|----------|----------|
| Rebates | 6.9      | 8.4      |
| Other   | 86.1     | 83.0     |
|         | \$ 227.5 | \$ 250.1 |

(7) Stock-Based Compensation

The Company's stock-based compensation expense for the three and six months ended June 30, 2017 and 2016 included PRSUs, non-qualified stock options, restricted stock units ("RSUs") and deferred stock units ("DSUs"). A summary of the Company's stock-based compensation expense is presented in the following table.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

| (in millions)                          | Three<br>Months<br>Ended<br>June 30, |       | Six Months<br>Ended<br>June 30, |        |
|--|--------------------------------------|-------|---------------------------------|--------|
|  | 2017                                 | 2016  | 2017                            | 2016   |
| PRSU expense (benefit)                 | \$1.2                                | \$1.7 | \$(8.1)                         | \$4.2  |
| Option expense                         | 1.8                                  | 1.1   | 3.8                             | 2.8    |
| RSU/DSU expense                        | 3.0                                  | 1.7   | 6.9                             | 3.6    |
| Total stock-based compensation expense | \$6.0                                | \$4.5 | \$2.6                           | \$10.6 |

During the six months ended June 30, 2017, the Company recorded a \$9.3 million benefit in the Condensed Consolidated Statements of Income related to a change in estimate associated with performance-based stock compensation that is no longer probable of payout as a result of the termination of the Mattress Firm relationship.

The Company did not record any accelerated stock-based compensation expense during each of the three months ended June 30, 2017 and 2016. During the six months ended June 30, 2017 and 2016, the Company recorded \$0.9 million and \$2.0 million of accelerated stock-based compensation expense associated with executive management transition, respectively.

The Company has 1.2 million PRSUs outstanding that will vest if the Company achieves more than \$650.0 million of adjusted earnings before interest, tax, depreciation and amortization ("Adjusted EBITDA") for 2017 (the "2017 Aspirational Plan PRSUs"). All of the 2017 Aspirational Plan PRSUs will vest in full if the Company achieves Adjusted EBITDA in 2017 greater than \$650.0 million. In addition, if this target is not met in 2017 but the Company achieves more than \$650.0 million in Adjusted EBITDA for 2018, then one-third of the total 2017 Aspirational Plan PRSUs will vest, and the remaining 2017 Aspirational Plan PRSUs will be forfeited. If the Company does not achieve more than \$650.0 million of Adjusted EBITDA in either 2017 or 2018, then all of the 2017 Aspirational Plan PRSUs will be forfeited. Adjusted EBITDA is defined as the Company's "Consolidated EBITDA" as such term is defined in the Company's 2012 Credit Agreement.

The Company did not record any stock-based compensation expense related to the 2017 Aspirational Plan PRSUs during the three and six months ended June 30, 2017 and 2016, as it is not considered probable that the Company will achieve the specified performance target as of December 31, 2017 or December 31, 2018. The Company will continue to evaluate the probability of achieving the performance condition in future periods and record the appropriate expense if necessary. Based on the price of the Company's common stock on the grant date, the total unrecognized compensation expense related to this award if the performance target is met for 2017 is \$83.9 million, which would be expensed over the remaining service period if achievement of the performance condition becomes probable.

## (8) Commitments and Contingencies

(a) Alvin Todd, and Henry and Mary Thompson, individually and on behalf of all others similarly situated, Plaintiffs v. Tempur Sealy International, Inc., formerly known as Tempur-Pedic International, Inc. and Tempur-Pedic North America, LLC, Defendants; filed October 25, 2013.

On October 25, 2013, a suit was filed against Tempur Sealy International and one of its domestic subsidiaries in the United States District Court for the Northern District of California, purportedly on behalf of a proposed class of "consumers" as defined by Cal. Civ. Code § 1761(d) who purchased, not for resale, a Tempur-Pedic mattress or pillow

in the State of California. On November 19, 2013, the Company was served for the first time in the case but with an amended petition adding additional class representatives for additional states. The purported classes seek certification of claims under applicable state laws.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

The complaint alleges that the Company engaged in unfair business practices, false advertising, and misrepresentations or omissions related to the sale of certain products. The Plaintiffs seek restitution, injunctive relief and all other relief allowed under applicable state laws, interest, attorneys' fees and costs. The purported classes do not seek damages for physical injuries. The Company believes the case lacks merit and intends to defend against the claims vigorously. The Court was scheduled to consider class certification motions in the fourth quarter of 2015; however, the Plaintiffs filed a Motion to Amend the Complaint, at which time the Company filed a Motion to Dismiss the Amended Complaint. A hearing on the Motion to Dismiss was held January 28, 2016 and the Court denied in part and granted in part the Company's Motion to Dismiss, allowing certain claims to proceed. The Court considered class certification motions on August 18, 2016, and on September 30, 2016, denied the Plaintiffs' Motion for class certification. In December 2016, the Ninth Circuit Court of Appeals affirmed the lower court's decision. The Company filed a Motion to Sever the Claims made by each of the Plaintiffs on March 22, 2017 following the denial of class certification by the District Court which was affirmed by the Ninth Circuit Court of Appeals. The Plaintiffs then filed a Motion for Reconsideration at the District Court with respect to the denial of class certification on April 12, 2017 based on a change in the law. That Motion was denied on June 30, 2017. The Court also granted the Company's Motion to Sever the claims on June 30, 2017, dissolving the potential class and requiring the Plaintiffs to file individual cases in their home states if they wish to proceed. The Company is unable to determine whether the Company's applicable insurance policies will provide sufficient coverage for these claims and the costs of defense of these claims. Accordingly, the Company can give no assurance that this matter will not have a material adverse effect on the Company's financial position or results of operations.

(b) David Buehring, Individually and on Behalf of All Others Similarly Situated v. Tempur Sealy International, Inc., Scott L. Thompson, and Barry A. Hytinen, filed March 24, 2017.

On March 24, 2017, a suit was filed against Tempur Sealy International, Inc., and two of its officers in the U.S. District Court for the Southern District of New York, purportedly on behalf of a proposed class of stockholders who purchased Tempur Sealy common stock between July 28, 2016 and January 27, 2017. The complaint alleges that the Company made materially false and misleading statements regarding its then existing and future financial prospects, including those with one of its retailers, Mattress Firm, allegedly in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The Company does not believe the claims have merit and intends to vigorously defend against these claims. The case is in the early stages of litigation. As a result, the outcome of the case is unclear and the Company is unable to reasonably estimate the possible loss or range of loss, if any. Accordingly, the Company can give no assurance that this matter will not have a material adverse effect on the Company's financial position or results of operations.

(c) Myla Gardner v. Scott L. Thompson, Barry A. Hytinen, Evelyn S. Dilsaver, John A. Heil, Jon L. Luther, Usman Nabi, Richard W. Neu, Robert B. Trussell, Jr. and Tempur Sealy International, Inc., filed July 10, 2017; Paul Onesti v. Scott L. Thompson, Barry A. Hytinen, Evelyn S. Dilsaver, John A. Heil, Jon L. Luther, Usman Nabi, Richard W. Neu, Robert B. Trussell, Jr. and Tempur Sealy International, Inc., filed July 21, 2017; and Joseph L. Doherty v. Scott L. Thompson, Barry A. Hytinen, Evelyn S. Dilsaver, John A. Heil, Jon L. Luther, Usman Nabi, Richard W. Neu, Robert B. Trussell, Jr. and Tempur Sealy International, Inc., filed July 20, 2017.

During July, three putative shareholder derivative suits were filed against the Company, each member of its Board of Directors and two of its officers. Each complaint alleges that the Board of Directors and officers caused the Company to make materially false and misleading statements regarding its business and financial prospects, including those with one of its retailers, Mattress Firm, which was a violation of the fiduciary duties they owed to the Company. The Company does not believe any of the suits have merit and intends to vigorously defend against the claims in each

case. These cases are in the early stages of litigation. As a result, the outcome of each case is unclear and the Company is unable to reasonably estimate the possible loss or range of loss, if any. The Plaintiffs in two of the cases have agreed to Orders staying their respective actions until forty-five days after a decision is rendered on the Motion to Dismiss in the Buehring action noted above.



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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

(d) Mattress Firm, Inc. v. Tempur-Pedic North America, LLC and Sealy Mattress Company, filed March 30, 2017.

On March 30, 2017, a suit was filed against Tempur-Pedic and Sealy Mattress (two wholly-owned subsidiaries of the Company) in the District Court of Harris County, Texas by Mattress Firm. The complaint alleges breach of contract, tortious interference and seeks a declaratory judgment with respect to the interpretation of its agreements with the Company. On April 7, 2017, the Company's subsidiaries named above filed suit against Mattress Firm, Inc. in the U.S. District Court for the Southern District of Texas, Houston Division seeking injunctive relief and damages for trademark infringement, unfair competition and trademark dilution in violation of the Lanham Act, and breach of contract and other state law violations. The complaint alleges that Mattress Firm violated the parties' transition agreements dated January 30, 2017, and consequently, federal and state law, by its use of the Company's trademarks after April 3, 2017. On April 28, 2017, the complaint was amended to add a claim by Sealy Mattress for nonpayment by Mattress Firm for products sold and delivered. On May 23, 2017, the complaint was further amended to add allegations that Mattress Firm continued to use the Company's trade names and trademarks on its website and in advertising in an inappropriate manner. On July 11, 2017, the Court issued a preliminary injunction prohibiting Mattress Firm from using the Company's names and marks in such manner. The Company does not believe the claims asserted by Mattress Firm have merit and intends to vigorously defend against them. The cases are in the early stages of litigation. As a result, the outcome remains unclear and the Company is unable to reasonably estimate the possible loss or range of loss, if any. Accordingly, the Company can give no assurance that these matters will not have a material adverse effect on the Company's financial position or results of operations.

(e) Other. 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 other pending legal proceedings in the aggregate will not have a material adverse effect on its business, financial condition, liquidity, or operating results.

(9) Income Taxes

The Company's effective tax rate for the three months ended June 30, 2017 and 2016 was 37.6% and 31.5%, respectively. The Company's effective tax rate for the six months ended June 30, 2017 and 2016 was 34.0% and 31.0%, respectively. The Company's income tax rate for the three and six months ended June 30, 2017 and 2016 differed from the U.S. federal statutory rate of 35.0% principally due to certain foreign income tax rate differentials, state and local income taxes, the production activities deduction, certain other permanent differences, changes in the Company's uncertain tax positions, and for the three and six months ended June 30, 2017, the excess tax deficiency related to stock-based compensation.

The Company has received income tax assessments from the Danish Tax Authority ("SKAT") with respect to the tax years 2001 through 2008 relating to the royalty paid by a U.S. subsidiary of Tempur Sealy International to a Danish subsidiary (the "Danish Assessments"). The royalty is paid by the U.S. subsidiary for the right to utilize certain intangible assets owned by the Danish subsidiary in the U.S. production process. In its assessment, SKAT asserts that the amount of royalty rate paid by the U.S. subsidiary to the Danish subsidiary is not reflective of an arms-length transaction. Accordingly, the tax assessment received from SKAT is based, in part, on a 20% royalty rate, which is substantially higher than that historically used or deemed appropriate by the Company.

The cumulative total tax assessment at June 30, 2017 for all years for which an assessment has been received (2001 - 2008) is approximately Danish Krone ("DKK") 1,592.8 million, including interest and penalties (\$244.4 million, based on the DKK to USD exchange rate on June 30, 2017). The cumulative total tax assessment at December 31, 2016 for all years for which an assessment had been received up through that date (2001 - 2008) including interest and penalties was approximately DKK 1,547.3 million (\$219.3 million), based on the DKK to USD exchange rate on

December 31, 2016. If SKAT continues to issue assessments for each year not currently assessed, the Company expects the aggregate assessments for such years (2009 - 2016) to be in excess of the amounts described above as assessed for the years 2001 - 2008 (collectively the years 2001 through 2016 are referred to as the "Danish Tax Matter").

At June 30, 2017 and December 31, 2016 the Company had accrued Danish tax and interest for the Danish Tax Matter of approximately DKK 852 million (approximately \$131.0 million using the June 30, 2017 exchange rate) and DKK 850 million (approximately \$120.6 million using the December 31, 2016 exchange rate), respectively, as an uncertain income tax liability. On both June 30, 2017 and December 31, 2016 approximately DKK 835 million (approximately \$128.5 million using June 30, 2017 exchange rate and \$118.5 million using the December 31, 2016 exchange rate) represents the amount that the Company and SKAT preliminarily agreed to in a non-binding proposed resolution for the years 2001 through 2011. The balance at June 30, 2017 and December 31, 2016, respectively, of approximately DKK 17 million (approximately \$2.5 million using the June 30, 2017 exchange

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

rate) and DKK 15 million (approximately \$2.1 million using the December 31, 2016 exchange rate) may be subject to further negotiation in the future as part of an Advanced Pricing Agreement the Company may choose to pursue for years after 2011. The amount accrued is included in other non-current liabilities on the Company's Condensed Consolidated Balance Sheets. In addition, at June 30, 2017 and December 31, 2016 the Company had recorded a deferred tax asset of approximately \$44.3 million and \$43.5 million, respectively, for the U.S. correlative benefit related to this matter. The Company has recorded a valuation allowance with respect to this benefit of approximately \$17.6 million for both periods related to years for which relief may not be realized.

The Company's uncertain tax liability associated with the Danish Tax Matter is derived using the cumulative probability analysis with possible outcomes based on the Company's updated evaluation of the facts and circumstances regarding this matter and applying the technical requirements applicable to U.S., Danish, and international transfer pricing standards as required by GAAP, taking into account both the U.S. and Danish income tax implications of such outcomes. Both the uncertain tax liability and the deferred tax asset discussed herein reflects the Company's best judgment of the facts, circumstances and information available through June 30, 2017.

If the Company is not successful in defending its position before the Danish National Tax Tribunal (the "Tribunal"), the appeals division within SKAT, or in the Danish courts or in negotiating a mutually acceptable settlement, there is significant risk that the Company could be required to pay significant amounts to SKAT in excess of any related reserve. Such an outcome could have a material adverse impact on the Company's profitability and liquidity. In addition, prior to any ultimate resolution of this issue before the Tribunal or the Danish courts, based on a change in facts and circumstances, the Company may be required to further increase its uncertain tax liability associated with this matter, which could have a material impact on the Company's reported earnings.

From June 2012 through June 30, 2017, SKAT withheld Value Added Tax refunds otherwise owed to the Company, pending resolution of the Danish Tax Matter. Total withheld refunds at June 30, 2017 and December 31, 2016 are approximately DKK 296.7 million (approximately \$45.5 at the June 30, 2017 exchange rate) and DKK 258.0 million (approximately \$36.6 million at the December 31, 2016 exchange rate), respectively. In July 2016, the Company paid a deposit to SKAT in the amount of approximately DKK 615.2 (approximately \$94.4 million using the exchange rate at June 30, 2017) (the "Tax Deposit") and applied approximately DKK 224.6 million (approximately \$34.5 million using the exchange rate at June 30, 2017) of its Value Added Tax refund (the "VAT Refund Applied") to the aforementioned potential Danish income tax liability, consistent with the Company's reserve position for the Danish Tax Matter. The deposit was made to mitigate additional interest and foreign exchange exposure. The Tax Deposit and the VAT Refund Applied are included within other non-current assets on the Condensed Consolidated Balance Sheets.

The amount of unrecognized tax benefits that would impact the effective tax rate if recognized at June 30, 2017 and December 31, 2016 would be \$27.5 and \$21.4 million (exclusive of interest and penalties), respectively. Interest and penalties related to unrecognized tax benefits are recorded in income tax provision. It is reasonably possible that there could be material changes to the amount of uncertain tax positions due to activities of the taxing authorities, settlement of audit issues, reassessment of existing uncertain tax positions, including the Danish Tax Matter, or the expiration of applicable statute of limitations; however, the Company is not able to estimate the impact of these items at this time. There were no significant changes to the liability for unrecognized tax benefits during the three months ended June 30, 2017.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## (10) Earnings Per Common Share

The following table sets forth the components of the numerator and denominator for the computation of basic and diluted earnings per share for net income attributable to Tempur Sealy International.

|  | Three Months Ended |        | Six Months Ended |        |
|--|--------------------|--------|------------------|--------|
|  | June 30, 2017      | 2016   | June 30, 2017    | 2016   |
| (in millions, except per common share amounts)                                     |                    |        |                  |        |
| Numerator:   |                    |        |                  |        |
| Net income attributable to Tempur Sealy International, Inc.                        | \$24.5             | \$21.3 | \$58.4           | \$60.9 |
| Denominator:   |                    |        |                  |        |
| Denominator for basic earnings per common share-weighted average shares            | 53.9               | 60.2   | 53.9             | 61.1   |
| Effect of dilutive securities:   |                    |        |                  |        |
| Employee stock-based compensation  | 0.6                | 0.6    | 0.7              | 0.6    |
| Denominator for diluted earnings per common share-adjusted weighted average shares | 54.5               | 60.8   | 54.6             | 61.7   |
| Basic earnings per common share  | \$0.45             | \$0.35 | \$1.08           | \$1.00 |
| Diluted earnings per common share  | \$0.45             | \$0.35 | \$1.07           | \$0.99 |

The Company excluded 1.5 million and 0.4 million shares issuable upon exercise of outstanding stock options for the three months ended June 30, 2017 and 2016, respectively, from the diluted earnings per common share computation because their exercise price was greater than the average market price of Tempur Sealy International's common stock or they were otherwise anti-dilutive. The Company excluded 1.5 million and 0.4 million shares issuable upon exercise of outstanding stock options for the six months ended June 30, 2017 and 2016, respectively, from the diluted earnings per common share computation because their exercise price was greater than the average market price of Tempur Sealy International'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.

## (11) Business Segment Information

The Company operates in two segments: North America and International. Corporate operating expenses are not included in either of the segments and are presented separately as a reconciling item to consolidated results. These segments are strategic business units that are managed separately based on geography. The North America segment consists of Tempur and Sealy manufacturing and distribution subsidiaries, joint ventures and licensees located in the U.S. and Canada. The International segment consists of Tempur and Sealy manufacturing and distribution subsidiaries, joint ventures and licensees located in Europe, Asia-Pacific and Latin America. The Company evaluates segment performance based on net sales, gross profit and operating income.

The Company's North America and International segment assets include investments in subsidiaries that are appropriately eliminated in the Company's accompanying Condensed Consolidated Financial Statements. The remaining inter-segment eliminations are comprised of intercompany accounts receivable and payable.

The following table summarizes total assets by segment:

| (in millions) | June 30, 2017 | December 31, 2016 |
|---------------|---------------|-------------------|
|---------------|---------------|-------------------|

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|                            |            |            |
|----------------------------|------------|------------|
| North America              | \$2,689.1  | \$ 2,581.4 |
| International              | 612.4      | 572.6      |
| Corporate                  | 649.9      | 658.7      |
| Inter-segment eliminations | (1,240.2 ) | (1,110.1 ) |
| Total assets               | \$2,711.2  | \$ 2,702.6 |

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

The following table summarizes property, plant and equipment, net by segment:

| (in millions)                            | June 30, December 31, |          |
|--|-----------------------|----------|
|  | 2017                  | 2016     |
| North America                            | \$ 295.8              | \$ 297.4 |
| International                            | 54.0                  | 54.9     |
| Corporate                                | 75.0                  | 69.9     |
| Total property, plant and equipment, net | \$ 424.8              | \$ 422.2 |

The following table summarizes segment information for the three months ended June 30, 2017:

| (in millions)                          | North<br>America | International | Corporate | Eliminations | Consolidated |
|--|------------------|---------------|-----------|--------------|--------------|
| Net sales                              | \$ 525.4         | \$ 133.9      | \$ —      | \$ —         | \$ 659.3     |
| Inter-segment sales                    | \$ 1.3           | \$ 0.2        | \$ —      | \$ (1.5 )    | \$ —         |
| Inter-segment royalty expense (income) | 1.2              | (1.2 )        | —         | —            | —            |
| Gross profit                           | 198.9            | 69.7          | —         | —            | 268.6        |
| Operating income (loss)                | 55.8             | 26.3          | (25.5 )   | —            | 56.6         |
| Income (loss) before income taxes      | 54.3             | 24.9          | (44.4 )   | —            | 34.8         |

Depreciation and amortization <sup>(1)</sup> \$ 12.9 \$ 3.6 \$ 9.6 \$ — \$ 26.1

Capital expenditures 5.1 2.1 5.8 — 13.0

(1) Depreciation and amortization includes stock-based compensation amortization expense.

The following table summarizes segment information for the three months ended June 30, 2016:

| (in millions)                          | North<br>America | International | Corporate | Eliminations | Consolidated |
|--|------------------|---------------|-----------|--------------|--------------|
| Net sales                              | \$ 668.2         | \$ 136.2      | \$ —      | \$ —         | \$ 804.4     |
| Inter-segment sales                    | \$ 1.3           | \$ 0.1        | \$ —      | \$ (1.4 )    | \$ —         |
| Inter-segment royalty expense (income) | 2.1              | (2.1 )        | —         | —            | —            |
| Gross profit                           | 267.3            | 69.6          | —         | —            | 336.9        |
| Operating income (loss)                | 103.3            | 23.2          | (26.3 )   | —            | 100.2        |
| Income (loss) before income taxes      | 100.2            | 21.0          | (92.0 )   | —            | 29.2         |

Depreciation and amortization <sup>(1)</sup> \$ 10.9 \$ 3.9 \$ 8.1 \$ — \$ 22.9

Capital expenditures 5.7 2.4 3.6 — 11.7

(1) Depreciation and amortization includes stock-based compensation amortization expense.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

The following table summarizes segment information for the six months ended June 30, 2017:

| (in millions)                          | North<br>America | International | Corporate | Eliminations | Consolidated |
|--|------------------|---------------|-----------|--------------|--------------|
| Net sales                              | \$1,107.7        | \$ 273.7      | \$ —      | \$ —         | \$ 1,381.4   |
| Inter-segment sales                    | \$2.2            | \$ 0.3        | \$ —      | \$ (2.5 )    | \$ —         |
| Inter-segment royalty expense (income) | 2.9              | (2.9 )        | —         | —            | —            |
| Gross profit                           | 413.4            | 141.8         | —         | —            | 555.2        |
| Operating income (loss)                | 107.1            | 52.2          | (43.2 )   | —            | 116.1        |
| Income (loss) before income taxes      | 113.7            | 48.6          | (80.9 )   | —            | 81.4         |

Depreciation and amortization <sup>(1)</sup> \$25.2 \$ 7.3 \$ 9.8 \$ — \$ 42.3

Capital expenditures 13.7 3.6 8.6 — 25.9

(1) Depreciation and amortization includes stock-based compensation amortization expense.

The following table summarizes segment information for the six months ended June 30, 2016:

| (in millions)                          | North<br>America | International | Corporate | Eliminations | Consolidated |
|--|------------------|---------------|-----------|--------------|--------------|
| Net sales                              | \$1,248.2        | \$ 277.2      | \$ —      | \$ —         | \$ 1,525.4   |
| Inter-segment sales                    | \$2.5            | \$ 0.1        | \$ —      | \$ (2.6 )    | \$ —         |
| Inter-segment royalty expense (income) | 3.8              | (3.8 )        | —         | —            | —            |
| Gross profit                           | 481.8            | 146.1         | —         | —            | 627.9        |
| Operating income (loss)                | 180.6            | 50.5          | (54.2 )   | —            | 176.9        |
| Income (loss) before income taxes      | 177.2            | 45.4          | (137.1 )  | —            | 85.5         |

Depreciation and amortization <sup>(1)</sup> \$21.2 \$ 7.8 \$ 17.6 \$ — \$ 46.6

Capital expenditures 11.3 4.7 8.3 — 24.3

(1) Depreciation and amortization includes stock-based compensation amortization expense.

The following table summarizes property, plant and equipment, net by geographic region:

| (in millions)                            | June 30, December 31, |          |
|--|-----------------------|----------|
|  | 2017                  | 2016     |
| United States                            | \$ 363.8              | \$ 360.7 |
| Canada                                   | 7.0                   | 6.6      |
| Other International                      | 54.0                  | 54.9     |
| Total property, plant and equipment, net | \$ 424.8              | \$ 422.2 |
| Total International                      | \$ 61.0               | \$ 61.5  |

The following table summarizes net sales by geographic region:

| (in millions) | Three Months<br>Ended |                  | Six Months Ended |                  |
|---------------|-----------------------|------------------|------------------|------------------|
|               | June 30,<br>2017      | June 30,<br>2016 | June 30,<br>2017 | June 30,<br>2016 |
| United States | \$471.2               | \$614.1          | \$1,004.7        | \$1,151.3        |

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|                     |         |         |           |           |
|---------------------|---------|---------|-----------|-----------|
| Canada              | 54.2    | 54.1    | 103.0     | 96.9      |
| Other International | 133.9   | 136.2   | 273.7     | 277.2     |
| Total net sales     | \$659.3 | \$804.4 | \$1,381.4 | \$1,525.4 |
| Total International | \$188.1 | \$190.3 | \$376.7   | \$374.1   |

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

(12) Guarantor/Non-Guarantor Financial Information

The \$450.0 million and \$600.0 million aggregate principal amount of 2023 Senior Notes and 2026 Senior Notes (collectively the "Senior Notes"), respectively, are general unsecured senior obligations of Tempur Sealy International and are fully and unconditionally guaranteed on a senior unsecured basis, jointly and severally, by all of Tempur Sealy International's 100% directly or indirectly owned current and future domestic subsidiaries (the "Combined Guarantor Subsidiaries"). The foreign subsidiaries (the "Combined Non-Guarantor Subsidiaries") represent the foreign operations of the Company and do not guarantee the Senior Notes. A subsidiary guarantor will be released from its obligations under the applicable indenture governing the Senior Notes when: (a) the subsidiary guarantor is sold or sells all or substantially all of its assets; (b) the subsidiary is declared "unrestricted" under the applicable indenture governing the Senior Notes; (c) the subsidiary's guarantee of indebtedness under the 2016 Credit Agreement (as it may be amended, refinanced or replaced) is released (other than a discharge through repayment); or (d) the requirements for legal or covenant defeasance or discharge of the applicable indenture have been satisfied. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions, including transactions with the Company's wholly-owned subsidiary guarantors and non-guarantor subsidiaries. The Company has accounted for its investments in its subsidiaries under the equity method.

The following supplemental financial information presents the Condensed Consolidated Statements of Income and Comprehensive Income for the three and six months ended June 30, 2017 and 2016, the Condensed Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016, and the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and 2016 for Tempur Sealy International, Combined Guarantor Subsidiaries and Combined Non-Guarantor Subsidiaries.

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended June 30, 2017

(in millions)

|   | Tempur<br>Sealy<br>International<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--|---------------------------------------|---|--------------|--------------|
| Net sales   | \$ —   | \$ 472.4                              | \$ 205.7                                  | \$ (18.8 )   | \$ 659.3     |
| Cost of sales   | —  | 290.2                                 | 119.3                                     | (18.8 )      | 390.7        |
| Gross profit  | —  | 182.2                                 | 86.4                                      | —            | 268.6        |
| Selling and marketing expenses  | 1.4  | 102.3                                 | 48.6                                      | —            | 152.3        |
| General, administrative and other expenses                            | 4.9  | 45.5                                  | 18.6                                      | —            | 69.0         |
| Equity income in earnings of unconsolidated affiliates                | —  | —                                     | (4.4 )                                    | —            | (4.4 )       |
| Royalty income, net of royalty expense                                | —  | (4.9 )                                | —   | —            | (4.9 )       |
| Operating (loss) income   | (6.3 )   | 39.3                                  | 23.6                                      | —            | 56.6         |
| Other expense, net:   |  |                                       |   |              |              |
| Third party interest expense, net                                     | 14.9   | 6.4                                   | 0.8                                       | —            | 22.1         |
| Intercompany interest (income) expense, net                           | (1.2 )   | 3.0                                   | (1.8 )                                    | —            | —            |
| Interest expense (income), net  | 13.7   | 9.4                                   | (1.0 )                                    | —            | 22.1         |
| Other expense (income), net   | —  | 0.2                                   | (0.5 )                                    | —            | (0.3 )       |
| Total other expense (income), net                                     | 13.7   | 9.6                                   | (1.5 )                                    | —            | 21.8         |
| Income from equity investees  | 34.7   | 16.3                                  | —   | (51.0 )      | —            |
| Income before income taxes  | 14.7   | 46.0                                  | 25.1                                      | (51.0 )      | 34.8         |
| Income tax benefit (provision)  | 7.0  | (11.3 )                               | (8.8 )                                    | —            | (13.1 )      |
| Net income before non-controlling interests                           | 21.7   | 34.7                                  | 16.3                                      | (51.0 )      | 21.7         |
| Less: Net loss attributable to non-controlling interests              | (2.8 )   | —                                     | (2.8 )                                    | 2.8          | (2.8 )       |
| Net income attributable to Tempur Sealy International, Inc.           | \$ 24.5  | \$ 34.7                               | \$ 19.1                                   | \$ (53.8 )   | \$ 24.5      |
| Comprehensive income attributable to Tempur Sealy International, Inc. | \$ 33.7  | \$ 34.5                               | \$ 28.5                                   | \$ (63.0 )   | \$ 33.7      |

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended June 30, 2016

(in millions)

|   | Tempur<br>Sealy<br>International<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--|---------------------------------------|---|--------------|--------------|
| Net sales   | \$ —   | \$ 628.3                              | \$ 190.8                                  | \$ (14.7 )   | \$ 804.4     |
| Cost of sales   | —  | 376.9                                 | 105.3                                     | (14.7 )      | 467.5        |
| Gross profit  | —  | 251.4                                 | 85.5                                      | —            | 336.9        |
| Selling and marketing expenses  | 0.9  | 126.1                                 | 45.8                                      | —            | 172.8        |
| General, administrative and other expenses                            | 4.0  | 51.0                                  | 16.9                                      | —            | 71.9         |
| Equity income in earnings of unconsolidated affiliates                | —  | —                                     | (3.4 )                                    | —            | (3.4 )       |
| Royalty (income) expense, net   | —  | (4.7 )                                | 0.1                                       | —            | (4.6 )       |
| Operating (loss) income   | (4.9 )   | 79.0                                  | 26.1                                      | —            | 100.2        |
| Other expense, net:   |  |                                       |   |              |              |
| Third party interest expense, net                                     | 16.1   | 6.1                                   | 0.9                                       | —            | 23.1         |
| Intercompany interest (income) expense, net                           | (1.1 )   | 0.1                                   | 1.0                                       | —            | —            |
| Interest expense, net   | 15.0   | 6.2                                   | 1.9                                       | —            | 23.1         |
| Loss on extinguishment of debt  | 34.3   | 12.9                                  | —   | —            | 47.2         |
| Other expense, net  | —  | 0.2                                   | 0.5                                       | —            | 0.7          |
| Total other expense, net  | 49.3   | 19.3                                  | 2.4                                       | —            | 71.0         |
| Income from equity investees  | 55.2   | 19.2                                  | —   | (74.4 )      | —            |
| Income before income taxes  | 1.0  | 78.9                                  | 23.7                                      | (74.4 )      | 29.2         |
| Income tax benefit (provision)  | 19.0   | (23.7 )                               | (4.5 )                                    | —            | (9.2 )       |
| Net income before non-controlling interests                           | 20.0   | 55.2                                  | 19.2                                      | (74.4 )      | 20.0         |
| Less: Net loss attributable to non-controlling interests              | (1.3 )   | (1.3 )                                | —   | 1.3          | (1.3 )       |
| Net income attributable to Tempur Sealy International, Inc.           | \$ 21.3  | \$ 56.5                               | \$ 19.2                                   | \$ (75.7 )   | \$ 21.3      |
| Comprehensive income attributable to Tempur Sealy International, Inc. | \$ 18.0  | \$ 57.0                               | \$ 15.4                                   | \$ (72.4 )   | \$ 18.0      |

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Six Months Ended June 30, 2017

(in millions)

|   | Tempur<br>Sealy<br>International<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--|---------------------------------------|---|--------------|--------------|
| Net sales   | \$ —   | \$ 1,002.2                            | \$ 418.4                                  | \$ (39.2 )   | \$ 1,381.4   |
| Cost of sales   | —  | 620.5                                 | 244.9                                     | (39.2 )      | 826.2        |
| Gross profit  | —  | 381.7                                 | 173.5                                     | —            | 555.2        |
| Selling and marketing expenses  | 2.8  | 207.2                                 | 96.0                                      | —            | 306.0        |
| General, administrative and other expenses                            | 8.9  | 89.8                                  | 36.8                                      | —            | 135.5        |
| Customer termination charges, net                                     | (8.4 )   | 21.8                                  | 1.0                                       |              | 14.4         |
| Equity income in earnings of unconsolidated affiliates                | —  | —                                     | (7.1 )                                    | —            | (7.1 )       |
| Royalty income, net of royalty expense                                | —  | (9.7 )                                | —   | —            | (9.7 )       |
| Operating (loss) income   | (3.3 )   | 72.6                                  | 46.8                                      | —            | 116.1        |
| Other expense, net:   |  |                                       |   |              |              |
| Third party interest expense, net                                     | 29.7   | 12.9                                  | 1.6                                       | —            | 44.2         |
| Intercompany interest (income) expense, net                           | (2.4 )   | 2.8                                   | (0.4 )                                    | —            | —            |
| Interest expense, net   | 27.3   | 15.7                                  | 1.2                                       | —            | 44.2         |
| Other income, net   | —  | (9.2 )                                | (0.3 )                                    | —            | (9.5 )       |
| Total other expense, net  | 27.3   | 6.5                                   | 0.9                                       | —            | 34.7         |
| Income from equity investees  | 75.3   | 31.9                                  | —   | (107.2 )     | —            |
| Income before income taxes  | 44.7   | 98.0                                  | 45.9                                      | (107.2 )     | 81.4         |
| Income tax benefit (provision)  | 9.0  | (22.7 )                               | (14.0 )                                   | —            | (27.7 )      |
| Net income before non-controlling interests                           | 53.7   | 75.3                                  | 31.9                                      | (107.2 )     | 53.7         |
| Less: Net loss attributable to non-controlling interests              | (4.7 )   | —                                     | (4.7 )                                    | 4.7          | (4.7 )       |
| Net income attributable to Tempur Sealy International, Inc.           | \$ 58.4  | \$ 75.3                               | \$ 36.6                                   | \$ (111.9 )  | \$ 58.4      |
| Comprehensive income attributable to Tempur Sealy International, Inc. | \$ 75.9  | \$ 70.6                               | \$ 58.8                                   | \$ (129.4 )  | \$ 75.9      |

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Six Months Ended June 30, 2016

(in millions)

|   | Tempur<br>Sealy<br>International<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--|---------------------------------------|---|--------------|--------------|
| Net sales   | \$ —   | \$ 1,179.0                            | \$ 374.8                                  | \$ (28.4 )   | \$ 1,525.4   |
| Cost of sales   | —  | 725.2                                 | 200.7                                     | (28.4 )      | 897.5        |
| Gross profit  | —  | 453.8                                 | 174.1                                     | —            | 627.9        |
| Selling and marketing expenses  | 2.7  | 228.3                                 | 91.9                                      | —            | 322.9        |
| General, administrative and other expenses                            | 8.8  | 102.0                                 | 32.8                                      | —            | 143.6        |
| Equity income in earnings of unconsolidated affiliates                | —  | —                                     | (6.2 )                                    | —            | (6.2 )       |
| Royalty (income) expense, net   | —  | (9.5 )                                | 0.2                                       | —            | (9.3 )       |
| Operating (loss) income   | (11.5 )  | 133.0                                 | 55.4                                      | —            | 176.9        |
| Other expense, net:   |  |                                       |   |              |              |
| Third party interest expense, net                                     | 36.2   | 6.9                                   | 1.4                                       | —            | 44.5         |
| Intercompany interest (income) expense, net                           | (2.2 )   | —                                     | 2.2                                       | —            | —            |
| Interest expense, net   | 34.0   | 6.9                                   | 3.6                                       | —            | 44.5         |
| Loss on extinguishment of debt  | 34.3   | 12.9                                  | —   | —            | 47.2         |
| Other (income) expense, net   | —  | (1.4 )                                | 1.1                                       | —            | (0.3 )       |
| Total other expense, net  | 68.3   | 18.4                                  | 4.7                                       | —            | 91.4         |
| Income from equity investees  | 111.7  | 41.2                                  | —   | (152.9 )     | —            |
| Income before income taxes  | 31.9   | 155.8                                 | 50.7                                      | (152.9 )     | 85.5         |
| Income tax benefit (provision)  | 27.1   | (44.1 )                               | (9.5 )                                    | —            | (26.5 )      |
| Net income before non-controlling interests                           | 59.0   | 111.7                                 | 41.2                                      | (152.9 )     | 59.0         |
| Less: Net loss attributable to non-controlling interests              | (1.9 )   | (1.9 )                                | —   | 1.9          | (1.9 )       |
| Net income attributable to Tempur Sealy International, Inc.           | \$ 60.9  | \$ 113.6                              | \$ 41.2                                   | \$ (154.8 )  | \$ 60.9      |
| Comprehensive income attributable to Tempur Sealy International, Inc. | \$ 71.8  | \$ 114.2                              | \$ 51.4                                   | \$ (165.6 )  | \$ 71.8      |



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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Balance Sheets

June 30, 2017

(in millions)

|   | Tempur<br>Sealy<br>International,<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|---|---------------------------------------|---|--------------|--------------|
| <b>ASSETS</b>   |   |                                       |   |              |              |
| Current Assets:   |   |                                       |   |              |              |
| Cash and cash equivalents   | \$ 0.2  | \$ 6.5                                | \$ 31.8                                   | \$—          | \$ 38.5      |
| Accounts receivable, net  | —   | 41.5                                  | 314.7                                     | —            | 356.2        |
| Inventories, net  | —   | 107.8                                 | 86.7                                      | —            | 194.5        |
| Income taxes receivable   | 247.5   | —                                     | —   | (247.5)      | —            |
| Prepaid expenses and other current assets                                       | 0.5   | 37.4                                  | 20.5                                      | —            | 58.4         |
| Total Current Assets  | 248.2   | 193.2                                 | 453.7                                     | (247.5)      | 647.6        |
| Property, plant and equipment, net  | —   | 350.0                                 | 74.8                                      | —            | 424.8        |
| Goodwill  | —   | 500.2                                 | 227.4                                     | —            | 727.6        |
| Other intangible assets, net  | —   | 583.3                                 | 89.6                                      | —            | 672.9        |
| Deferred income taxes   | 16.4  | —                                     | 25.5                                      | (16.4)       | 25.5         |
| Other non-current assets  | —   | 47.2                                  | 165.6                                     | —            | 212.8        |
| Net investment in subsidiaries  | 2,328.6   | 110.5                                 | —   | (2,439.1)    | —            |
| Due from affiliates   | 102.6   | 2,043.3                               | 11.9                                      | (2,157.8)    | —            |
| Total Assets  | \$ 2,695.8  | \$ 3,827.7                            | \$ 1,048.5                                | \$ (4,860.8) | \$ 2,711.2   |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                     |   |                                       |   |              |              |
| Current Liabilities:  |   |                                       |   |              |              |
| Accounts payable  | \$ —  | \$ 166.4                              | \$ 65.4                                   | \$—          | \$ 231.8     |
| Accrued expenses and other current liabilities                                  | 6.9   | 153.0                                 | 67.6                                      | —            | 227.5        |
| Income taxes payable  | —   | 245.0                                 | 12.4                                      | (247.5)      | 9.9          |
| Current portion of long-term debt   | —   | 35.2                                  | 33.2                                      | —            | 68.4         |
| Total Current Liabilities   | 6.9   | 599.6                                 | 178.6                                     | (247.5)      | 537.6        |
| Long-term debt, net   | 1,041.1   | 691.4                                 | 60.7                                      | —            | 1,793.2      |
| Deferred income taxes   | —   | 161.7                                 | 18.0                                      | (16.4)       | 163.3        |
| Other non-current liabilities   | —   | 45.9                                  | 144.1                                     | —            | 190.0        |
| Due to affiliates   | 1,620.7   | 0.5                                   | 536.6                                     | (2,157.8)    | —            |
| Total Liabilities   | 2,668.7   | 1,499.1                               | 938.0                                     | (2,421.7)    | 2,684.1      |
| Redeemable non-controlling interest   | 5.3   | —                                     | 5.3                                       | (5.3)        | 5.3          |
| Total Stockholders' Equity  | 21.8  | 2,328.6                               | 105.2                                     | (2,433.8)    | 21.8         |
| Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity | \$ 2,695.8  | \$ 3,827.7                            | \$ 1,048.5                                | \$ (4,860.8) | \$ 2,711.2   |





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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Balance Sheets

December 31, 2016

(in millions)

|   | Tempur<br>Sealy<br>International,<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|---|---------------------------------------|---|--------------|--------------|
| <b>ASSETS</b>   |   |                                       |   |              |              |
| Current Assets:   |   |                                       |   |              |              |
| Cash and cash equivalents   | \$ —  | \$ 7.9                                | \$ 57.8                                   | \$ —         | \$ 65.7      |
| Accounts receivable, net  | —   | 197.7                                 | 147.4                                     | —            | 345.1        |
| Inventories, net  | —   | 117.1                                 | 79.7                                      | —            | 196.8        |
| Income taxes receivable   | 234.2   | —                                     | —   | (234.2)      | —            |
| Prepaid expenses and other current assets   | —   | 48.9                                  | 15.0                                      | —            | 63.9         |
| Total Current Assets  | 234.2   | 371.6                                 | 299.9                                     | (234.2)      | 671.5        |
| Property, plant and equipment, net  | —   | 346.9                                 | 75.3                                      | —            | 422.2        |
| Goodwill  | —   | 500.2                                 | 222.3                                     | —            | 722.5        |
| Other intangible assets, net  | —   | 589.8                                 | 88.9                                      | —            | 678.7        |
| Deferred income taxes   | 20.6  | —                                     | 22.5                                      | (20.6)       | 22.5         |
| Other non-current assets  | —   | 41.7                                  | 143.5                                     | —            | 185.2        |
| Net investment in subsidiaries  | 2,207.4   | 77.7                                  | —   | (2,285.1)    | —            |
| Due from affiliates   | 168.4   | 1,874.7                               | 14.3                                      | (2,057.4)    | —            |
| Total Assets  | \$ 2,630.6  | \$ 3,802.6                            | \$ 866.7                                  | \$ (4,597.3) | \$ 2,702.6   |
| <b>LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>                                     |   |                                       |   |              |              |
| Current Liabilities:  |   |                                       |   |              |              |
| Accounts payable  | \$ 0.1  | \$ 157.0                              | \$ 62.2                                   | \$ —         | \$ 219.3     |
| Accrued expenses and other current liabilities  | 6.8   | 172.6                                 | 70.7                                      | —            | 250.1        |
| Income taxes payable  | —   | 235.9                                 | 4.1                                       | (234.2)      | 5.8          |
| Current portion of long-term debt   | —   | 34.4                                  | 35.9                                      | —            | 70.3         |
| Total Current Liabilities   | 6.9   | 599.9                                 | 172.9                                     | (234.2)      | 545.5        |
| Long-term debt, net   | 1,040.4   | 776.5                                 | 0.9                                       | —            | 1,817.8      |
| Deferred income taxes   | —   | 174.9                                 | 20.3                                      | (20.6)       | 174.6        |
| Other non-current liabilities   | —   | 43.3                                  | 126.0                                     | —            | 169.3        |
| Due to affiliates   | 1,587.9   | 0.6                                   | 468.9                                     | (2,057.4)    | —            |
| Total Liabilities   | 2,635.2   | 1,595.2                               | 789.0                                     | (2,312.2)    | 2,707.2      |
| Redeemable non-controlling interest   | 7.6   | —                                     | 7.6                                       | (7.6)        | 7.6          |
| Total Stockholders' (Deficit) Equity  | (12.2)  | 2,207.4                               | 70.1                                      | (2,277.5)    | (12.2)       |
| Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' (Deficit) Equity | \$ 2,630.6  | \$ 3,802.6                            | \$ 866.7                                  | \$ (4,597.3) | \$ 2,702.6   |



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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Statements of Cash Flows

Six Months Ended June 30, 2017

(in millions)

|  | Tempur<br>Sealy<br>International<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--|---------------------------------------|---|--------------|--------------|
| Net cash (used in) provided by operating activities                              | \$ (27.9 )   | \$ 226.9                              | \$ (123.8 )                               | \$           | —\$ 75.2     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                     |  |                                       |   |              |              |
| Purchases of property, plant and equipment                                       | —  | (20.8 )                               | (5.1 )                                    | —            | (25.9 )      |
| Contributions (paid to) received from subsidiaries and affiliates                | —  | (107.0 )                              | 107.0                                     | —            | —            |
| Other  | —  | 0.8                                   | 0.1                                       | —            | 0.9          |
| Net cash (used in) provided by investing activities                              | —  | (127.0 )                              | 102.0                                     | —            | (25.0 )      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                     |  |                                       |   |              |              |
| Proceeds from borrowings under long-term debt obligations                        | —  | 453.7                                 | 265.2                                     | —            | 718.9        |
| Repayments of borrowings under long-term debt obligations                        | —  | (538.6 )                              | (207.3 )                                  | —            | (745.9 )     |
| Net activity in investment in and advances from (to) subsidiaries and affiliates | 70.3   | (16.6 )                               | (53.7 )                                   | —            | —            |
| Proceeds from exercise of stock options  | 1.9  | —                                     | —   | —            | 1.9          |
| Treasury stock repurchased   | (44.1 )  | —                                     | —   | —            | (44.1 )      |
| Payment of deferred financing costs  | —  | —                                     | (0.4 )                                    | —            | (0.4 )       |
| Other  | —  | 0.2                                   | (2.9 )                                    | —            | (2.7 )       |
| Net cash provided by (used in) financing activities                              | 28.1   | (101.3 )                              | 0.9                                       | —            | (72.3 )      |
| <b>NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>          |  |                                       |   |              |              |
| Increase (decrease) in cash and cash equivalents                                 | 0.2  | (1.4 )                                | (26.0 )                                   | —            | (27.2 )      |
| CASH AND CASH EQUIVALENTS, beginning of period                                   | —  | 7.9                                   | 57.8                                      | —            | 65.7         |
| CASH AND CASH EQUIVALENTS, end of period   | \$ 0.2   | \$ 6.5                                | \$ 31.8                                   | \$           | —\$ 38.5     |

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## TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited) (continued)

## Supplemental Condensed Consolidated Statements of Cash Flows

Six Months Ended June 30, 2016

(in millions)

|  | Tempur<br>Sealy<br>International<br>Inc.<br>(Ultimate<br>Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|--|--|---------------------------------------|---|--------------|--------------|
| Net cash (used in) provided by operating activities                              | \$ (29.9 )   | \$ 32.3                               | \$ 49.5                                   | \$ —         | —\$ 51.9     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                     |  |                                       |   |              |              |
| Purchases of property, plant and equipment                                       | —  | (19.4 )                               | (4.9 )                                    | —            | (24.3 )      |
| Contributions (paid to) received from subsidiaries and affiliates                | —  | (40.1 )                               | 40.1                                      | —            | —            |
| Net cash (used in) provided by investing activities                              | —  | (59.5 )                               | 35.2                                      | —            | (24.3 )      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                     |  |                                       |   |              |              |
| Proceeds from borrowings under long-term debt obligations                        | 600.0  | 830.1                                 | 5.2                                       | —            | 1,435.3      |
| Repayments of borrowings under long-term debt obligations                        | (375.0 )   | (839.6 )                              | (15.8 )                                   | —            | (1,230.4 )   |
| Net activity in investment in and advances from (to) subsidiaries and affiliates | 45.7   | (17.1 )                               | (28.6 )                                   | —            | —            |
| Proceeds from exercise of stock options  | 6.0  | —                                     | —   | —            | 6.0          |
| Excess tax benefit from stock-based compensation                                 | 3.0  | —                                     | —   | —            | 3.0          |
| Treasury stock repurchased   | (217.3 )   | —                                     | —   | —            | (217.3 )     |
| Payment of deferred financing costs  | (2.9 )   | (3.3 )                                | —   | —            | (6.2 )       |
| Fees paid to lenders   | (6.0 )   | (1.8 )                                | —   | —            | (7.8 )       |
| Call premium on 2020 Senior Notes  | (23.6 )  | —                                     | —   | —            | (23.6 )      |
| Other  | —  | (1.0 )                                | 1.4                                       | —            | 0.4          |
| Net cash provided by (used in) financing activities                              | 29.9   | (32.7 )                               | (37.8 )                                   | —            | (40.6 )      |
| <b>NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>          |  |                                       |   |              |              |
| (Decrease) increase in cash and cash equivalents                                 | —  | (59.9 )                               | 43.9                                      | —            | (16.0 )      |
| CASH AND CASH EQUIVALENTS, beginning of period                                   | —  | 119.7                                 | 34.2                                      | —            | 153.9        |
| CASH AND CASH EQUIVALENTS, end of period   | \$ —   | \$ 59.8                               | \$ 78.1                                   | \$ —         | —\$ 137.9    |

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

The following discussion and analysis should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in ITEM 7 of Part II of the Annual Report, and accompanying Condensed Consolidated Financial Statements and accompanying notes included in this Form 10-Q. Unless otherwise noted, all of the financial information in this Report is consolidated financial information for the Company. The forward-looking statements in this discussion regarding the mattress and pillow industries, our expectations regarding our strategy, 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 "Risk Factors" elsewhere in this quarterly report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2016. 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 the three and six months ended June 30, 2017, including the following topics:

- an overview of our business;
- factors impacting results of operations;
- results of operations including our net sales and costs in the periods presented as well as changes between periods;
- expected sources of liquidity for future operations; and
- our use of certain non-GAAP financial measures.

#### Business Overview

##### General

We develop, manufacture and market bedding products, which we sell globally. Our brand portfolio includes many highly recognized brands in the industry, including Tempur®, Tempur-Pedic®, Sealy® featuring Posturepedic® Technology, and Stearns & Foster®. Our comprehensive suite of bedding products offers a variety of products to consumers across a broad range of channels.

##### Our Channels

In the first quarter of 2017, we updated our primary selling channels to Wholesale and Direct. These channels better align to the margin characteristics of our business and our marketplace. Wholesale includes all third party retailers, including third party distribution, hospitality and healthcare. Direct includes company-owned stores, e-commerce, and call centers. Historically, we reported our net sales in the Retail and Other sales channels. Retail included furniture and bedding retailers, department stores, specialty retailers and warehouse clubs. Other included direct-to-consumer, third party distributors, hospitality and healthcare customers.

##### Segments

We operate in two segments: North America and International. Corporate operating expenses are not included in either of the segments and are presented separately as a reconciling item to consolidated results. These segments are strategic business units that are managed separately based on geography. Our North America segment consists of Tempur and Sealy manufacturing and distribution subsidiaries, joint ventures and licensees located in the U.S. and Canada. Our International segment consists of Tempur and Sealy manufacturing and distribution subsidiaries, joint ventures and licensees located in Europe, Asia-Pacific and Latin America. We evaluate segment performance based on net sales, gross profit and operating income.

### Factors That Could Impact Results of Operations

The factors outlined below could impact our future results of operations. For more extensive discussion of these and other risk factors that could impact our future results of operations, please refer to "Risk Factors," under ITEM 1A of Part I and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That Could Impact Results of Operations" included in ITEM 7 of Part II of our Annual Report on Form 10-K for the year ended December 31, 2016.

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### 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 global economic environment continues to be challenging, and we expect the uncertainty to continue. We continue to make strategic investments, including: introducing new products; investing in increasing our global brand awareness; expanding our North American margins while maintaining market share; investing in our operating infrastructure to meet the requirements of our business; and taking other actions to further strengthen our business.

### Termination of Mattress Firm Relationship

Mattress Firm, Inc. ("Mattress Firm") was a customer within the North America segment and was our largest customer in 2016. Mattress Firm represented 6.9% and 22.4% of our sales in the first half of 2017 and 2016, respectively. Our net sales to Mattress Firm declined 72.0% in the first half of 2017 as compared to the first half of 2016. Excluding net sales to Mattress Firm, our net sales increased 8.6% in the first half of 2017 as compared to 2016.

During the week of January 23, 2017, we were unexpectedly notified by the senior management of Mattress Firm and representatives of Steinhoff International Holdings N. V. ("Steinhoff"), its parent company, of Mattress Firm's intent to terminate Mattress Firm's business relationship with us if we did not agree to considerable changes to our relationship with Mattress Firm, including significant economic concessions. We engaged in discussions to facilitate a mutually agreeable supply arrangement with Mattress Firm. However, the parties were unable to reach an agreement, and, on January 27, 2017, Tempur-Pedic North America, LLC ("Tempur-Pedic") and Sealy Mattress Company ("Sealy Mattress") issued formal termination notices for all of their products to Mattress Firm. On January 30, 2017, Tempur-Pedic and Sealy Mattress entered into transition agreements with Mattress Firm in which they agreed, among other things, to continue supplying Mattress Firm until April 3, 2017, at which time the parties' business relationship ended. We expect that the termination of our relationship with Mattress Firm will have a significant negative impact on our financial performance in the short-term, but that this termination is in the long-term interests of our stockholders.

In the second quarter of 2017, the wind down of our relationship with Mattress Firm disrupted the retail mattress market as Mattress Firm closed out its inventory of Tempur and Sealy products. We expect that the loss of Mattress Firm as a customer will cause a decrease in our market share in the United States in 2017 and will cause our net sales in 2017 to decline from our net sales in 2016, and as a result we expect to be less profitable in 2017 as compared to 2016. In order to address this issue and recapture market share and lost sales, we are working with our existing retailers to expand their offerings of our products and expand our distribution with new retailers and other distribution channels. Our ability to improve our net sales performance in 2017 as compared to current expectations will be driven primarily by how quickly we can recapture market share and net sales.

In the first quarter of 2017, we took steps to manage our cost structure as a result of the termination of the business relationship with Mattress Firm. Accordingly, we incurred certain customer termination charges, including non-cash write-offs. We incurred \$25.9 million in net charges associated with the termination of Mattress Firm. Cost of sales included \$11.5 million of charges related to the write-off of customer-unique inventory and increased product obligations. Operating expenses included \$14.4 million of net charges associated with the termination of Mattress Firm, including \$22.8 million of charges related to the write-off of the March 31, 2017 value of Mattress Firm incentives and marketing assets, employee-related expenses and professional fees, which were offset by \$8.4 million of benefit primarily related to the change in estimate associated with performance-based stock compensation that is no longer probable of payout as a result of the termination of the Mattress Firm relationship.

In managing our business and our costs going forward, we intend to manage our business with the primary goal of recapturing market share and net sales, and accordingly our expense reductions in the areas of manufacturing and marketing are not expected to be significant. On the manufacturing side of our operations, we will accept some lower operating efficiencies in the short term to retain our high quality manufacturing capabilities, which we expect the market will need over time. On the marketing side, we expect to increase our investment on an absolute dollar basis and as a percentage of sales consistent with our long-term strategy of building and maintaining our brands to drive sales, and this may have an incremental negative impact on our profitability in the short-term.

With respect to our cash flow and liquidity, we expect that the impact of the Mattress Firm termination will be unfavorable in 2017 as compared to 2016. With respect to the financial covenants in our debt facilities, we expect to remain in compliance with our financial covenants through the end of 2017 and beyond, notwithstanding the decrease in net sales and other impacts referred to above.

For further discussion of the risks associated with large customers, refer to "Risk Factors," under ITEM 1A of Part I and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That Could Impact Results of Operations" included in ITEM 7 of Part II of our Annual Report on Form 10-K for the year ended December 31, 2016.



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Financial Leverage and Liquidity

As of June 30, 2017, we had \$1,873.8 million of total debt outstanding, and our adjusted earnings before interest, tax, depreciation and amortization ("EBITDA"), which is a non-GAAP financial measure, was \$499.8 million for the twelve months ended June 30, 2017. Higher financial leverage makes us more vulnerable to general adverse competitive, economic and industry conditions. There can be no assurance that our business will generate sufficient cash flow from operations or that future borrowing will be available. As of June 30, 2017, our ratio of consolidated funded debt less qualified cash to adjusted EBITDA calculated in accordance with our 2016 Credit Agreement was 3.74 times, within the covenant in our debt agreements which limits this ratio to 5.00 times for the trailing twelve months ended June 30, 2017. For more information on this non-GAAP measure and compliance with our 2016 Credit Agreement, please refer to "Non-GAAP Financial Information" below.

Results of Operations

A summary of our results for the three months ended June 30, 2017 include:

Total net sales decreased 18.0% to \$659.3 million from \$804.4 million in the second quarter of 2016. On a constant currency basis, which is a non-GAAP financial measure, total net sales decreased 17.2%, with a decrease of 21.0% in the North America business segment and an increase of 1.6% in the International business segment.

Gross margin was 40.7% as compared to 41.9% in the second quarter of 2016.

Operating income decreased 43.5% to \$56.6 million as compared to \$100.2 million in the second quarter of 2016. Net income increased 15.0% to \$24.5 million as compared to \$21.3 million in the second quarter of 2016. Net income decreased 56.0% to \$24.5 million as compared to adjusted net income, which is a non-GAAP financial measure, of \$55.7 million in the second quarter of 2016. We had no adjustments to net income in the second quarter of 2017. We incurred a \$47.2 million loss on extinguishment of debt in the second quarter of 2016 in connection with financing activities in the second quarter of 2016.

EBITDA, which is a non-GAAP financial measure, decreased 30.6% to \$85.8 million as compared to \$123.7 million for the second quarter of 2016. EBITDA decreased 31.2% as compared to adjusted EBITDA, which is a non-GAAP financial measure, of \$124.7 million in the second quarter of 2016. We had no adjustments to EBITDA in the second quarter of 2017.

Earnings per diluted share ("EPS") increased 28.6% to \$0.45 as compared to \$0.35 in the second quarter of 2016. EPS decreased 51.1% to \$0.45 as compared to adjusted EPS, which is a non-GAAP financial measure, of \$0.92 in the second quarter of 2016.

For a discussion and reconciliation of non-GAAP financial measures as discussed above to the corresponding GAAP financial results, refer to the non-GAAP financial information set forth below under the heading "Non-GAAP Financial Information."

We may refer to net sales or earnings or other historical financial information on a "constant currency basis," which is a non-GAAP financial measure. These references to constant currency basis do not include operational impacts that could result from fluctuations in foreign currency rates. To provide information on a constant currency basis, the applicable financial results are adjusted based on a simple mathematical model that translates current period results in local currency using the comparable prior year period's currency conversion rate. This approach is used for countries where the functional currency is the local country currency. This information is provided so that certain financial results can be viewed without the impact of fluctuations in foreign currency rates, thereby facilitating period-to-period comparisons of business performance. Constant currency information is not recognized under U.S. GAAP, and it is not intended as an alternative to U.S. GAAP measures. Refer to ITEM 3 under Part I of this Report for a discussion of our foreign currency disclosure.



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## THREE MONTHS ENDED JUNE 30, 2017 COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2016

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

| (in millions, except percentages and per share amounts)     | Three Months Ended June 30, |         |         |         |
|---|-----------------------------|---------|---------|---------|
|   | 2017                        |         | 2016    |         |
| Net sales   | \$659.3                     | 100.0 % | \$804.4 | 100.0 % |
| Cost of sales   | 390.7                       | 59.3    | 467.5   | 58.1    |
| Gross profit  | 268.6                       | 40.7    | 336.9   | 41.9    |
| Selling and marketing expenses                              | 152.3                       | 23.1    | 172.8   | 21.5    |
| General, administrative and other expenses                  | 69.0                        | 10.5    | 71.9    | 8.9     |
| Equity income in earnings of unconsolidated affiliates      | (4.4 )                      | (0.7 )  | (3.4 )  | (0.4 )  |
| Royalty income, net of royalty expense                      | (4.9 )                      | (0.8 )  | (4.6 )  | (0.6 )  |
| Operating income  | 56.6                        | 8.6     | 100.2   | 12.5    |
| Other expense, net:   |                             |         |         |         |
| Interest expense, net                                       | 22.1                        | 3.3     | 23.1    | 2.9     |
| Loss on extinguishment of debt                              | —                           | —       | 47.2    | 5.9     |
| Other (income) expense, net                                 | (0.3 )                      | —       | 0.7     | —       |
| Total other expense, net                                    | 21.8                        | 3.3     | 71.0    | 8.8     |
| Income before income taxes                                  | 34.8                        | 5.3     | 29.2    | 3.6     |
| Income tax provision  | (13.1 )                     | (2.0 )  | (9.2 )  | (1.1 )  |
| Net income before non-controlling interests                 | 21.7                        | 3.3     | 20.0    | 2.5     |
| Less: Net loss attributable to non-controlling interests    | (2.8 )                      | (0.4 )  | (1.3 )  | (0.1 )  |
| Net income attributable to Tempur Sealy International, Inc. | \$24.5                      | 3.7 %   | \$21.3  | 2.6 %   |
| Earnings per common share:                                  |                             |         |         |         |
| Basic   | \$0.45                      |         | \$0.35  |         |
| Diluted   | \$0.45                      |         | \$0.35  |         |
| Weighted average common shares outstanding:                 |                             |         |         |         |
| Basic   | 53.9                        |         | 60.2    |         |
| Diluted   | 54.5                        |         | 60.8    |         |

## NET SALES

| (in millions)        | Three Months Ended June 30, |         |               |         |               |         |
|----------------------|-----------------------------|---------|---------------|---------|---------------|---------|
|                      | 2017                        |         | 2016          |         | 2016          |         |
|                      | Consolidated                |         | North America |         | International |         |
| Net sales by channel |                             |         |               |         |               |         |
| Wholesale channel    | \$604.4                     | \$766.0 | \$496.0       | \$655.8 | \$108.4       | \$110.2 |
| Direct channel       | 54.9                        | 38.4    | 29.4          | 12.4    | 25.5          | 26.0    |
| Total net sales      | \$659.3                     | \$804.4 | \$525.4       | \$668.2 | \$133.9       | \$136.2 |

Net sales decreased 18.0%, and on a constant currency basis decreased 17.2%. The decrease in net sales was driven by:



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North America net sales decreased \$142.8 million, or 21.4%. Net sales to Mattress Firm were \$1.2 million prior to the termination of our contract at the beginning of the quarter, which resulted in a net sales decrease of \$190.2 million in the second quarter of 2017 as compared to the same period in 2016. Excluding Mattress Firm, North America net sales increased \$47.5 million, or 10%, driven by growth across all of our brands. Net sales in the Wholesale channel decreased \$159.8 million, or 24.4%, driven primarily by the termination of our contract with Mattress Firm. Excluding sales to Mattress Firm, Wholesale net sales increased 6.5%. Net sales in our Direct channel increased \$17.0 million, or 137.1%, driven primarily by growth in e-commerce. Canada net sales increased 4.6% on a constant currency basis.

International net sales decreased 1.7%. On a constant currency basis, International net sales increased 1.6%, driven primarily by growth in Asia-Pacific and Latin America, which was offset by weakness in certain European markets. Net sales in the Wholesale channel increased 1.5% on a constant currency basis. Net sales in the Direct channel increased 1.9% on a constant currency basis.

## GROSS PROFIT

| (in millions, except percentages) | Three Months Ended June 30, |              |              |              |               |
|-----------------------------------|-----------------------------|--------------|--------------|--------------|---------------|
|                                   | 2017                        |              | 2016         |              | Margin Change |
|                                   | Gross Profit                | Gross Margin | Gross Profit | Gross Margin |               |
| North America                     | \$198.9                     | 37.9 %       | \$267.3      | 40.0 %       | (2.1) %       |
| International                     | 69.7                        | 52.1 %       | 69.6         | 51.1 %       | 1.0 %         |
| Consolidated gross margin         | \$268.6                     | 40.7 %       | \$336.9      | 41.9 %       | (1.2) %       |

Costs associated with net sales are recorded in cost of sales and include the costs of producing, shipping, warehousing, receiving and inspecting goods during the period, as well as depreciation and amortization of long-lived assets used in the manufacturing process.

Gross margin decreased 120 basis points. The principal factors impacting gross margin for each segment are discussed below.

North America gross margin decreased 210 basis points. The decrease was driven primarily by the termination of the Mattress Firm relationship, which resulted in fixed cost deleverage of 300 basis points on lower net sales and unfavorable brand mix of 150 basis points. The loss of net sales had a disproportionate impact on higher gross margin Tempur products. This was offset by 150 basis points of operational improvements. In addition, channel mix and floor model discounts were also favorable.

International gross margin increased 100 basis points. The increase was driven primarily by mix, partially offset by product launch expenses.

## OPERATING EXPENSES

| (in millions)                              | Three Months Ended June 30, |         |               |         |               |        |           |        |
|--|-----------------------------|---------|---------------|---------|---------------|--------|-----------|--------|
|  | 2017                        |         | 2016          |         | 2017          |        | 2016      |        |
|  | Consolidated                |         | North America |         | International |        | Corporate |        |
| Operating expenses:                        |                             |         |               |         |               |        |           |        |
| Advertising expenses                       | \$70.8                      | \$93.8  | \$62.2        | \$86.0  | \$8.6         | \$7.8  | \$—       | \$—    |
| Other selling and marketing expenses       | 81.5                        | 79.0    | 50.3          | 47.4    | 29.8          | 30.7   | 1.4       | 0.9    |
| General, administrative and other expenses | 69.0                        | 71.9    | 32.7          | 32.5    | 12.2          | 14.0   | 24.1      | 25.4   |
| Total operating expenses                   | \$221.3                     | \$244.7 | \$145.2       | \$165.9 | \$50.6        | \$52.5 | \$25.5    | \$26.3 |

Selling and marketing expenses include advertising and media production associated with the promotion of our brands, 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 expenses certain new product development costs, including market research and new product testing.

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General, administrative and other expenses include salaries and related expenses, information technology, professional fees, depreciation of buildings, furniture and fixtures, machinery, leasehold improvements and computer equipment, expenses for administrative functions and research and development costs.

Operating expenses decreased \$23.4 million or 9.6%, and increased 320 basis points as a percentage of net sales. The primary drivers of changes in operating expenses by segment are explained below.

North America operating expenses decreased \$20.7 million or 12.5% and increased 280 basis points as a percentage of net sales. The decrease in operating expenses was primarily driven by decreased participation in our wholesale cooperative advertising programs. This decrease was offset by increased investments in our brand advertising campaign.

International operating expenses decreased \$1.9 million or 3.6% and decreased 70 basis points as a percentage of net sales. The decrease in operating expenses was primarily driven by improved operating expense leverage, which was offset by increased investments in our advertising.

Corporate operating expenses decreased \$0.8 million, or 3.0%.

## OPERATING INCOME

| (in millions, except percentages) | Three Months Ended June 30, |                  |                  |                  |                         |  |
|-----------------------------------|-----------------------------|------------------|------------------|------------------|-------------------------|--|
|                                   | 2017                        |                  | 2016             |                  | Operating Margin Change |  |
|                                   | Operating Income            | Operating Margin | Operating Income | Operating Margin |                         |  |
| North America                     | \$55.8                      | 10.6 %           | \$103.3          | 15.5 %           | (4.9 )%                 |  |
| International                     | 26.3                        | 19.6 %           | 23.2             | 17.0 %           | 2.6 %                   |  |
|                                   | 82.1                        |                  | 126.5            |                  |                         |  |
| Corporate expenses                | (25.5 )                     |                  | (26.3 )          |                  |                         |  |
| Total operating income            | \$56.6                      | 8.6 %            | \$100.2          | 12.5 %           | (3.9 )%                 |  |

Operating income decreased \$43.6 million and operating margin decreased 390 basis points. The primary drivers of changes in operating income by segment are explained below.

North America operating income decreased \$47.5 million and operating margin decreased 490 basis points. The decline in operating margin was primarily driven by the termination of our contract with Mattress Firm at the beginning of the second quarter, which resulted in gross margin decline and unfavorable operating expense leverage. We also increased investments in our brand advertising campaign.

International operating income increased \$3.1 million and operating margin increased 260 basis points. The increase in operating margin was primarily driven by the improvement in gross margin, improved operating expense leverage and improved performance in our Asia joint venture operations, which was offset by increased investments in our direct advertising.

Corporate operating expenses decreased \$0.8 million.

## INTEREST EXPENSE, NET

| (in millions, except percentages) | Three Months Ended |      |        |
|-----------------------------------|--------------------|------|--------|
|                                   | June 30,           |      | %      |
|                                   | 2017               | 2016 | Change |
|                                   |                    |      |        |

Interest expense, net                      \$22.1 \$23.1 (4.3 )%

Interest expense, net, decreased \$1.0 million or 4.3%. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

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## LOSS ON EXTINGUISHMENT OF DEBT

In the second quarter of 2016, we issued our 2026 Senior Notes and completed our 2016 Credit Agreement. The net proceeds of the 2026 Senior Notes offering were used in part to redeem the 2020 Senior Notes. The net proceeds from the 2016 Credit Agreement were used to repay in full the 2012 Credit Agreement and to pay certain transaction fees and expenses incurred in connection with the 2016 Credit Agreement. In association with these transactions, we recorded a \$47.2 million loss on extinguishment of debt. The \$47.2 million loss includes a \$23.6 million premium on the prepayment of our 2020 Senior Notes, \$11.0 million and \$4.8 million of deferred financing costs ("DFC") write-offs for the 2012 Credit Agreement and 2020 Senior Notes, respectively, and \$1.9 million and \$5.9 million of lender expenses for the 2016 Credit Agreement and 2026 Senior Notes, respectively. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

## INCOME TAX PROVISION

| (in millions, except percentages) | Three Months Ended<br>June 30, |        |             |
|-----------------------------------|--------------------------------|--------|-------------|
|                                   | 2017                           | 2016   | %<br>Change |
| Income tax provision              | \$13.1                         | \$9.2  | 42.4 %      |
| Effective tax rate                | 37.6 %                         | 31.5 % |             |

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 income tax provision increased \$3.9 million. Our effective tax rate increased 610 basis points due to the net impact of discrete items for the three months ended June 30, 2017, which primarily related to the resolution of a tax matter in Latin America and the repatriation of cash from our Canadian subsidiary. There was no material net impact as the result of discrete items that impacted the effective tax rate in the period ending June 30, 2016.

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## SIX MONTHS ENDED JUNE 30, 2017 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2016

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

| (in millions, except per share amounts)                     | Six Months Ended June 30, |          |           |          |
|---|---------------------------|----------|-----------|----------|
|   | 2017                      |          | 2016      |          |
| Net sales   | \$1,381.4                 | 100.0 %  | \$1,525.4 | 100.0 %  |
| Cost of sales   | 826.2                     | 59.8     | 897.5     | 58.8     |
| Gross profit  | 555.2                     | 40.2     | 627.9     | 41.2     |
| Selling and marketing expenses                              | 306.0                     | 22.2     | 322.9     | 21.2     |
| General, administrative and other expenses                  | 135.5                     | 9.8      | 143.6     | 9.4      |
| Customer termination charges, net                           | 14.4                      | 1.0      | —         | —        |
| Equity income in earnings of unconsolidated affiliates      | (7.1                      | ) (0.5 ) | (6.2      | ) (0.4 ) |
| Royalty income, net of royalty expense                      | (9.7                      | ) (0.7 ) | (9.3      | ) (0.6 ) |
| Operating income  | 116.1                     | 8.4      | 176.9     | 11.6     |
| Other expense, net:   |                           |          |           |          |
| Interest expense, net                                       | 44.2                      | 3.2      | 44.5      | 2.9      |
| Loss on extinguishment of debt                              | —                         | —        | 47.2      | 3.1      |
| Other income, net   | (9.5                      | ) (0.7 ) | (0.3      | ) —      |
| Total other expense, net                                    | 34.7                      | 2.5      | 91.4      | 6.0      |
| Income before income taxes                                  | 81.4                      | 5.9      | 85.5      | 5.6      |
| Income tax provision  | (27.7                     | ) (2.0 ) | (26.5     | ) (1.7 ) |
| Net income before non-controlling interests                 | 53.7                      | 3.9      | 59.0      | 3.9      |
| Less: Net loss attributable to non-controlling interests    | (4.7                      | ) (0.3 ) | (1.9      | ) (0.1 ) |
| Net income attributable to Tempur Sealy International, Inc. | \$58.4                    | 4.2 %    | \$60.9    | 4.0 %    |
| Earnings per common share:                                  |                           |          |           |          |
| Basic   | \$1.08                    |          | \$1.00    |          |
| Diluted   | \$1.07                    |          | \$0.99    |          |
| Weighted average common shares outstanding:                 |                           |          |           |          |
| Basic   | 53.9                      |          | 61.1      |          |
| Diluted   | 54.6                      |          | 61.7      |          |

## NET SALES

| (in millions)        | Six Months Ended June 30, |           |               |           |               |         |
|----------------------|---------------------------|-----------|---------------|-----------|---------------|---------|
|                      | 2017                      |           | 2016          |           | 2016          |         |
|                      | Consolidated              |           | North America |           | International |         |
| Net sales by channel |                           |           |               |           |               |         |
| Wholesale channel    | \$1,276.7                 | \$1,451.1 | \$1,054.2     | \$1,225.3 | \$222.5       | \$225.8 |
| Direct channel       | 104.7                     | 74.3      | 53.5          | 22.9      | 51.2          | 51.4    |
| Total net sales      | \$1,381.4                 | \$1,525.4 | \$1,107.7     | \$1,248.2 | \$273.7       | \$277.2 |

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Net sales decreased \$144.0 million, or 9.4%, and on a constant currency basis decreased 8.7%. The decrease in net sales was driven by:

North America net sales decreased \$140.5 million, or 11.3%. Net sales to Mattress Firm were \$95.7 million prior to the termination of our contract at the beginning of the second quarter, which resulted in a net sales decrease of \$245.7 million in the first half of 2017 as compared to the same period in 2016. Excluding Mattress Firm, North America net sales increased \$105.2 million, or 11.6%, driven by growth across all of our brands. Net sales in the Wholesale channel decreased \$171.1 million, or 14.0%, driven primarily by the termination of our contract with Mattress Firm. Excluding sales to Mattress Firm, Wholesale net sales increased 8.4%. Net sales in our Direct channel increased \$30.6 million, or 133.6%, driven primarily by growth in e-commerce. Canada net sales increased 7.1% on a constant currency basis.

International net sales decreased 1.3%. On a constant currency basis, International net sales increased 2.4%, driven primarily by growth in Asia-Pacific and Latin America, which was offset by weakness in certain European markets. Net sales in the Wholesale channel increased 2.3% on a constant currency basis. Net sales in the Direct channel increased 2.7% on a constant currency basis.

**GROSS PROFIT**

| (in millions, except percentages) | Six Months Ended June 30, |              |              |              |               |
|-----------------------------------|---------------------------|--------------|--------------|--------------|---------------|
|                                   | 2017                      |              | 2016         |              | Margin Change |
|                                   | Gross Profit              | Gross Margin | Gross Profit | Gross Margin |               |
| North America                     | \$413.4                   | 37.3 %       | \$481.8      | 38.6 %       | (1.3 )%       |
| International                     | 141.8                     | 51.8 %       | 146.1        | 52.7 %       | (0.9 )%       |
| Consolidated gross margin         | \$555.2                   | 40.2 %       | \$627.9      | 41.2 %       | (1.0 )%       |

Costs associated with net sales are recorded in cost of sales and include the costs of producing, shipping, warehousing, receiving and inspecting goods during the period, as well as depreciation and amortization of long-lived assets used in the manufacturing process.

Gross margin decreased 100 basis points. The principal factors impacting gross margin for each segment are discussed below.

North America gross margin decreased 130 basis points. The decrease was driven primarily by the termination of the Mattress Firm relationship, which resulted in unfavorable brand mix of 130 basis points and fixed cost deleverage of 110 basis points. In the first quarter of 2017, we also recorded charges associated with the Mattress Firm termination for an unfavorable impact of 100 basis points. These charges included a \$5.4 million write-off of customer-unique inventory and \$6.1 million of increased product obligations. These were offset by 100 basis points of favorable channel mix. In addition, operational improvements and floor model discounts were also favorable.

International gross margin decreased 90 basis points. The decrease was driven primarily by product launch expenses.

**OPERATING EXPENSES**

| (in millions)        | Six Months Ended June 30, |         |               |         |               |        |           |     |
|----------------------|---------------------------|---------|---------------|---------|---------------|--------|-----------|-----|
|                      | 2017                      |         | 2016          |         | 2017          |        | 2016      |     |
|                      | Consolidated              |         | North America |         | International |        | Corporate |     |
| Operating expenses:  |                           |         |               |         |               |        |           |     |
| Advertising expenses | \$144.0                   | \$170.8 | \$127.0       | \$152.1 | \$17.0        | \$18.7 | \$—       | \$— |

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|  |         |         |         |         |         |         |        |        |
|--|---------|---------|---------|---------|---------|---------|--------|--------|
| Other selling and marketing expenses       | 162.0   | 152.1   | 99.0    | 88.5    | 60.2    | 60.9    | 2.8    | 2.7    |
| General, administrative and other expenses | 135.5   | 143.6   | 63.5    | 64.3    | 24.3    | 27.6    | 47.7   | 51.7   |
| Customer termination charges, net          | 14.4    | —       | 20.9    | —       | 0.8     | —       | (7.3 ) | —      |
| Total operating expenses                   | \$455.9 | \$466.5 | \$310.4 | \$304.9 | \$102.3 | \$107.2 | \$43.2 | \$54.4 |

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Selling and marketing expenses include advertising and media production associated with the promotion of our brands, 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 expenses certain new product development costs, including market research and new product testing.

General, administrative and other expenses include salaries and related expenses, information technology, professional fees, depreciation of buildings, furniture and fixtures, machinery, leasehold improvements and computer equipment, expenses for administrative functions and research and development costs.

Operating expenses decreased \$10.6 million or 2.3% and increased 240 basis points as a percentage of net sales. The primary drivers of changes in operating expenses by segment are explained below.

North America operating expenses increased \$5.5 million and increased 360 basis points as a percentage of net sales. In the first quarter of 2017, we recorded \$20.9 million of charges related to the Mattress Firm termination, which included the \$17.2 million write-off of the March 31, 2017 value of customer incentives and marketing assets and \$3.7 million of employee-related and professional fees. Additionally, we increased investments in our brand advertising campaign, which were offset by decreased participation in our wholesale cooperative advertising programs.

International operating expenses decreased \$4.9 million and decreased 130 basis points as a percentage of net sales. The decrease in operating expenses was driven by improved operating expense leverage and lower advertising expenses. Additionally, we recorded \$0.8 million of charges for certain employee-related expenses in the first quarter of 2017.

Corporate operating expenses decreased \$11.2 million, or 20.6%. The decrease in operating expenses was primarily driven by a \$9.3 million benefit recorded in the first quarter of 2017 for the change in estimate associate with performance-based stock compensation that is no longer probable of payout following the Mattress Firm termination, offset by \$0.9 million of accelerated stock-based compensation and \$1.1 million of other employee-related expenses and professional fees. Additionally, we incurred \$3.0 million of executive management transition expenses in the first quarter of 2016.

Research and development expenses for the six months ended June 30, 2017 were \$11.5 million compared to \$13.1 million for the six months ended June 30, 2016, a decrease of \$1.6 million, or 12.2%.

## OPERATING INCOME

| (in millions, except percentages) | Six Months Ended June 30, |                  |                  |                  |                         |  |
|-----------------------------------|---------------------------|------------------|------------------|------------------|-------------------------|--|
|                                   | 2017                      |                  | 2016             |                  | Operating Margin Change |  |
|                                   | Operating Income          | Operating Margin | Operating Income | Operating Margin |                         |  |
| North America                     | \$107.1                   | 9.7 %            | \$180.6          | 14.5 %           | (4.8 )%                 |  |
| International                     | 52.2                      | 19.1 %           | 50.5             | 18.2 %           | 0.9 %                   |  |
|                                   | 159.3                     |                  | 231.1            |                  |                         |  |
| Corporate expenses                | (43.2 )                   |                  | (54.2 )          |                  |                         |  |
| Total operating income            | \$116.1                   | 8.4 %            | \$176.9          | 11.6 %           | (3.2 )%                 |  |

Operating income decreased \$60.8 million and operating margin decreased 320 basis points. The decrease was driven by:

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North America operating income decreased \$73.5 million and operating margin declined 480 basis points. The decline in operating margin was primarily driven by the termination of our contract with Mattress Firm at the beginning of the second quarter, which resulted in gross margin decline and unfavorable operating expense leverage. The decline in operating margin was also driven by charges of \$32.4 million recorded in the first quarter of 2017 associated with the Mattress Firm termination. Cost of sales included \$11.5 million of charges related to the write-off of customer-unique inventory and increased product obligations. Operating expenses included \$20.9 million of charges related to the write-off of customer incentives and marketing assets, as well as employee-related expenses.

International operating income increased \$1.7 million and operating margin improved 90 basis points. The increase in operating margin was primarily driven by improved operating expense leverage and improved performance in our Asia joint venture operations.

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Corporate operating expenses decreased \$11.0 million, which improved our consolidated operating margin by 80 basis points. In the first quarter of 2017, we recorded \$8.4 million of net stock-based compensation benefit.

## INTEREST EXPENSE, NET

|                                   | Six Months Ended<br>June 30, |        |             |
|-----------------------------------|------------------------------|--------|-------------|
| (in millions, except percentages) | 2017                         | 2016   | %<br>Change |
| Interest expense, net             | \$44.2                       | \$44.5 | (0.7 )%     |

Interest expense, net, decreased \$0.3 million or 0.7%. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

## LOSS ON EXTINGUISHMENT OF DEBT

In the second quarter of 2016, we issued our 2026 Senior Notes and completed our 2016 Credit Agreement. The net proceeds of the 2026 Senior Notes offering were used in part to redeem the 2020 Senior Notes. The net proceeds from the 2016 Credit Agreement were used to repay in full the 2012 Credit Agreement and to pay certain transaction fees and expenses incurred in connection with the 2016 Credit Agreement. In association with these transactions, we recorded a \$47.2 million loss on extinguishment of debt. The \$47.2 million loss includes a \$23.6 million premium on the prepayment of our 2020 Senior Notes, \$11.0 million and \$4.8 million of DFC write-offs for the 2012 Credit Agreement and 2020 Senior Notes, respectively, and \$1.9 million and \$5.9 million of lender expenses for the 2016 Credit Agreement and 2026 Senior Notes, respectively. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

## OTHER INCOME, NET

Other income included \$9.3 million of payments received pursuant to the transition agreements with Mattress Firm, which were entered into during the first quarter of 2017. In the fourth quarter of 2016, we spent approximately \$13 million to support Mattress Firm with store transitions and product launches. The \$9.3 million of payments received from Mattress Firm in the first quarter of 2017 were intended to partially reimburse that prior investment.

## INCOME TAX PROVISION

|                                   | Six Months Ended June<br>30, |        |             |
|-----------------------------------|------------------------------|--------|-------------|
| (in millions, except percentages) | 2017                         | 2016   | %<br>Change |
| Income tax provision              | \$27.7                       | \$26.5 | 4.5 %       |
| Effective tax rate                | 34.0 %                       | 31.0 % |             |

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 income tax provision increased \$1.2 million. Our effective tax rate increased 300 basis points as the result of the net impact of discrete items for the six months ended June 30, 2017, which primarily related to the resolution of a tax matter in Latin America and the repatriation of cash from our Canadian subsidiary. There was no material net impact as the result of discrete items that impacted the effective tax rate in the period ending June 30, 2016.

## Liquidity and Capital Resources

## Liquidity

Our principal sources of funds are cash flows from operations, borrowings made pursuant to our credit facilities and cash and cash equivalents on hand. Principal uses of funds consist of payments of principal and interest on our debt facilities, share repurchases, capital expenditures and working capital needs. As of June 30, 2017, we had working capital of \$110.0 million, including cash and cash equivalents of \$38.5 million, as compared to working capital of \$126.0 million including \$65.7 million in cash and cash equivalents as of December 31, 2016.



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The decrease in working capital was primarily driven by decreases in cash and cash equivalents and prepaid expenses and other current assets, as well as increases in accounts payable and income taxes payable. These were offset by a decrease in accrued expenses and other current liabilities and an increase in accounts receivable. The decrease in cash and cash equivalents was primarily due to payments of principal and interest on our debt facilities, our share repurchase program and operating capital needs. Prepaid expenses and other current assets decreases were driven primarily by decreases in marketing assets as a result of the Mattress Firm termination. Accounts payable changes are driven primarily by the timing of payments to vendors. Income taxes payable changes are driven primarily by the timing of estimated income tax payments. Accrued expenses and other current liabilities decreases are driven primarily by the funding of employee compensation and customer incentive programs based on 2016 results. Accounts receivable changes are driven primarily by net sales, in addition to timing of customer collections.

The table below presents net cash provided by (used in) operating, investing and financing activities for the periods indicated below:

| (in millions)                   | Six Months<br>Ended June<br>30, |         |
|---------------------------------|---------------------------------|---------|
|                                 | 2017                            | 2016    |
| Net cash provided by (used in): |                                 |         |
| Operating activities            | \$75.2                          | \$51.9  |
| Investing activities            | (25.0 )                         | (24.3 ) |
| Financing activities            | (72.3 )                         | (40.6 ) |

Cash provided by operating activities increased \$23.3 million in the six months ended June 30, 2017 as compared to the same period in 2016. The increase in cash provided by operating activities was primarily driven by changes in accounts receivable, inventories and accounts payable, which were offset by accrued expenses and other current liabilities. Additionally, we recorded a loss on extinguishment of debt of \$47.2 million associated with financing activities in 2016. Cash provided by operating activities includes \$9.3 million for payments received pursuant to the transition agreements with Mattress Firm, or \$6.4 million net of tax.

Cash used in investing activities increased \$0.7 million in the six months ended June 30, 2017 as compared to the same period in 2016.

Cash used in financing activities increased \$31.7 million in the six months ended June 30, 2017 as compared to the same period in 2016. In the first half of 2017, we made net repayments of \$27.0 million on our credit facilities, as compared to net borrowings of \$204.9 million in the first half of 2016. This decrease was primarily offset by a decrease in share repurchases of \$173.2 million in the first half of 2017 as compared to the same period in 2016. Additionally, we incurred other costs associated with the financing activities in the first half of 2016.

### Capital Expenditures

Capital expenditures totaled \$25.9 million and \$24.3 million for the six months ended June 30, 2017 and 2016, respectively. We currently expect our 2017 capital expenditures to be approximately \$60 to \$70 million, which relate to continued strategic investments that we believe will support our future plans.

### Debt Service

On April 12, 2017, we entered into a securitization transaction with respect to certain accounts receivable. In connection with this transaction, we entered into a credit agreement that provides for revolving loans to be made from time to time in a maximum amount that varies over the course of the year based on seasonality subject to an overall

limit of \$120.0 million. The revolving loans bear interest at a floating rate equal to a one month LIBOR index plus 80 basis points.

Our obligations under the securitization transaction are secured by the accounts receivable and certain related rights and contain customary events of default. We continue to own the accounts receivable, which continue to be reflected as assets on our Condensed Consolidated Balance Sheets. Borrowings under this facility are classified as long-term debt within the Condensed Consolidated Balance Sheets. This credit agreement matures on April 12, 2019. As of June 30, 2017, the amount outstanding under this facility was \$60.1 million.

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Our total debt decreased to \$1,873.8 million as of June 30, 2017 from \$1,901.0 million as of December 31, 2016. After giving effect to letters of credit outstanding of \$21.9 million under the 2016 Credit Agreement, total availability under the revolver was \$391.1 million as of June 30, 2017. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for further discussion of our debt and applicable interest rates.

As of June 30, 2017, our ratio of consolidated funded debt less qualified cash to adjusted EBITDA in accordance with our 2016 Credit Agreement was 3.74 times, within the terms of the consolidated total net leverage ratio covenant set forth in the 2016 Credit Agreement, which limits this ratio to 5.00 times. As of June 30, 2017, we were in compliance with all of the financial covenants in our debt agreements.

Our business continues to generate significant cash flows from operations. Our target ratio of consolidated funded debt less qualified cash to adjusted EBITDA is 3.5 times, and we expect that this ratio could typically range from 3.0 times to 4.0 times. Subject to market conditions, we also expect to continue repurchasing shares.

For additional information, refer to "Non-GAAP Financial Information" below for the calculation of the ratio of consolidated funded debt less qualified cash to adjusted EBITDA calculated in accordance with our 2016 Credit Agreement. Both consolidated funded debt and adjusted EBITDA in accordance with our 2016 Credit Agreement 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.

Non-GAAP Financial Information

We provide information regarding adjusted net income, adjusted EPS, adjusted gross profit, adjusted gross margin, adjusted operating income (expense), adjusted operating margin, EBITDA, adjusted EBITDA, free cash flow, consolidated funded debt and consolidated funded debt less qualified cash, which are not recognized terms under GAAP and do not purport to be alternatives to net income and earnings per share as a measure of operating performance or total debt. We believe these non-GAAP measures provide investors with performance measures that better reflect our underlying operations and trends, including trends in changes in margin and operating expenses, providing a perspective not immediately apparent from net income and operating income. The adjustments management makes to derive the non-GAAP measures include adjustments to exclude items that may cause short-term fluctuations in the nearest GAAP measure, but which management does not consider to be the fundamental attributes or primary drivers of our business, including costs associated with our 2013 acquisition of Sealy Corporation and its subsidiaries ("Sealy Acquisition"), the exclusion of other costs associated with the 2015 Annual Meeting (including executive management transition and retention compensation), legal settlements, costs associated with the completion of the 2016 Credit Agreement and senior notes offering in the second quarter of 2016, the exclusion of charges associated with the Mattress Firm termination in the first quarter of 2017 and other costs.

We believe that exclusion of these items assists in providing a more complete understanding of our underlying results from continuing operations and trends, and management uses these measures along with the corresponding GAAP financial measures to manage our business, to evaluate our consolidated and business segment performance compared to prior periods and the marketplace, to establish operational goals and to provide continuity to investors for comparability purposes. Limitations associated with the use of these non-GAAP measures include that these measures do not present all of the amounts associated with our results as determined in accordance with U.S. GAAP and these non-GAAP measures should be considered supplemental in nature and should not be construed as more significant than comparable measures defined by U.S. GAAP. Because not all companies use identical calculations, these presentations may not be comparable to other similarly titled measures of other companies. For more information about these non-GAAP measures and a reconciliation to the nearest GAAP measure, please refer to the reconciliations on the following pages.

Second Quarter 2017 Key Highlights

| (in millions, except percentages and per common share amounts) | Three Months Ended |               | % Change | % Change Constant Currency (1) |
|--|--------------------|---------------|----------|--------------------------------|
|  | June 30, 2017      | June 30, 2016 |          |                                |
| Net sales  | \$659.3            | \$804.4       | (18.0)%  | (17.2)%                        |
| Net income   | 24.5               | 21.3          | 15.0%    | 20.2%                          |
| EPS  | 0.45               | 0.35          | 28.6%    | 34.3%                          |
| Adjusted EPS (1)   | 0.45               | 0.92          | (51.1)%  | (48.9)%                        |
| EBITDA (1)   | 85.8               | 123.7         | (30.6)%  | (29.2)%                        |

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(1) Non-GAAP financial measure. Please refer to the reconciliations in the following tables.

## Adjusted Net Income and Adjusted EPS

A reconciliation of GAAP net income to adjusted net income and a calculation of adjusted EPS is provided below. Management believes that the use of these non-GAAP financial measures provides investors with additional useful information with respect to the impact of various adjustments as described in the footnotes at the end of the following table.

The following table sets forth the reconciliation of our GAAP net income to adjusted net income and a calculation of adjusted EPS for the three months ended June 30, 2017 and 2016:

| (in millions, except per share amounts)       | Three Months<br>Ended |                  |
|---|-----------------------|------------------|
|   | June 30,<br>2017      | June 30,<br>2016 |
| GAAP net income                               | \$24.5                | \$ 21.3          |
| Loss on extinguishment of debt <sup>(1)</sup> | —                     | 47.2             |
| Interest expense <sup>(2)</sup>               | —                     | 2.1              |
| Integration costs <sup>(3)</sup>              | —                     | 1.0              |
| Tax adjustments <sup>(4)</sup>                | —                     | (15.9 )          |
| Adjusted net income                           | \$24.5                | \$ 55.7          |
| Adjusted earnings per common share, diluted   | \$0.45                | \$ 0.92          |
| Diluted shares outstanding                    | 54.5                  | 60.8             |

(1) Loss on extinguishment of debt represents costs associated with the completion of a credit facility and senior notes offering in the second quarter of 2016.

(2) Interest expense represents incremental interest incurred in connection with the completion of a senior notes offering in the second quarter of 2016.

(3) Integration costs represents costs, including legal fees, professional fees, compensation costs and other charges related to the transition of manufacturing facilities, and other costs related to the continued alignment of the North America business segment related to the Sealy Acquisition.

(4) Adjusted income tax provision represents adjustments associated with the aforementioned items and other discrete income tax events.

## Adjusted Gross Profit and Gross Margin and Adjusted Operating Income (Expense) and Operating Margin

A reconciliation of GAAP gross profit and gross margin to adjusted gross profit and gross margin, respectively, and GAAP operating income (expense) and operating margin to adjusted operating income (expense) and operating margin, respectively, is provided below. We believe that the use of these non-GAAP financial measures provides investors with additional useful information with respect to the impact of various adjustments as described in the footnotes at the end of the following table.

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The following table sets forth our reported GAAP gross profit and operating income (expense) for the three months ended June 30, 2017. We had no adjustments to GAAP gross profit and operating income (expense) for the three months ended June 30, 2017:

| (in millions, except percentages) | Three Months Ended June 30, 2017 |                      |                      |                  |  |  |            |
|-----------------------------------|----------------------------------|----------------------|----------------------|------------------|--|--|------------|
|                                   | Consolidated Margin              | North America Margin | International Margin | Corporate Margin |  |  |            |
| Net sales                         | \$659.3                          | \$ 525.4             | \$ 133.9             |                  |  |  | \$ —       |
| Gross profit                      | \$268.6 40.7 %                   | \$ 198.9 37.9 %      | \$ 69.7 52.1 %       |                  |  |  | \$ —       |
| Operating income (expense)        | \$56.6 8.6 %                     | \$ 55.8 10.6 %       | \$ 26.3 19.6 %       |                  |  |  | \$ (25.5 ) |

The following table sets forth the reconciliation of our reported GAAP gross profit and operating income (expense) to the calculation of adjusted gross profit and operating income (expense) for the three months ended June 30, 2016:

| (in millions, except percentages)   | Three Months Ended June 30, 2016 |                          |                      |                      |  |  |            |
|-------------------------------------|----------------------------------|--------------------------|----------------------|----------------------|--|--|------------|
|                                     | Consolidated Margin              | North America Margin (1) | International Margin | Corporate Margin (2) |  |  |            |
| Net sales                           | \$804.4                          | \$ 668.2                 | \$ 136.2             |                      |  |  | \$ —       |
| Gross profit                        | \$336.9 41.9 %                   | \$ 267.3 40.0 %          | \$ 69.6 51.1 %       |                      |  |  | \$ —       |
| Adjustments                         | 0.1                              | 0.1                      | —                    |                      |  |  | —          |
| Adjusted gross profit               | \$337.0 41.9 %                   | \$ 267.4 40.0 %          | \$ 69.6 51.1 %       |                      |  |  | \$ —       |
| Operating income (expense)          | \$100.2 12.5 %                   | \$ 103.3 15.5 %          | \$ 23.2 17.0 %       |                      |  |  | \$ (26.3 ) |
| Adjustments                         | 1.0                              | 0.4                      | —                    |                      |  |  | 0.6        |
| Adjusted operating income (expense) | \$101.2 12.6 %                   | \$ 103.7 15.5 %          | \$ 23.2 17.0 %       |                      |  |  | \$ (25.7 ) |

(1) Adjustments for the North America business segment represent integration costs (which include compensation costs, professional fees and other charges related to the transition of manufacturing facilities) and other costs to support the continued alignment of the North America business segment related to the Sealy Acquisition in the second quarter of 2016.

(2) Adjustments for Corporate represent integration costs, which include professional fees and other charges to align the business related to the Sealy Acquisition in the second quarter of 2016.

#### EBITDA, Adjusted EBITDA, Consolidated Funded Debt Less Qualified Cash and Free Cash Flow

The following reconciliations are provided below:

GAAP net income to EBITDA and adjusted EBITDA

Total debt to consolidated funded debt less qualified cash

Ratio of consolidated funded debt less qualified cash to adjusted EBITDA

Net cash from operating activities to free cash flow

We believe that presenting these non-GAAP measures provides investors with useful information with respect to our operating performance and comparisons from period to period, as well as general information about our progress in reducing our leverage.

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The following table sets forth the reconciliation of our reported GAAP net income to the calculations of EBITDA and adjusted EBITDA for the three months ended June 30, 2017 and 2016:

| (in millions)                                 | Three Months Ended |               |
|---|--------------------|---------------|
|   | June 30, 2017      | June 30, 2016 |
| GAAP net income                               | \$24.5             | \$21.3        |
| Loss on extinguishment of debt <sup>(1)</sup> | —                  | 47.2          |
| Interest expense, net                         | 22.1               | 23.1          |
| Income taxes                                  | 13.1               | 9.2           |
| Depreciation and amortization                 | 26.1               | 22.9          |
| EBITDA  | \$85.8             | \$123.7       |
| Adjustments:                                  |                    |               |
| Integration costs <sup>(2)</sup>              | —                  | 1.0           |
| Adjusted EBITDA                               | \$85.8             | \$124.7       |

(1) Loss on extinguishment of debt represents costs associated with the completion of a credit facility and senior notes offering in the second quarter of 2016.

Integration costs represents costs, including legal fees, professional fees, compensation costs and other charges related to the transition of manufacturing facilities, and other costs related to the continued alignment of the North America business segment related to the Sealy Acquisition.

The following table sets forth the reconciliation of our net income to the calculations of EBITDA and adjusted EBITDA for the trailing twelve months ended June 30, 2017:

| (in millions)  | Trailing Twelve Months Ended June 30, 2017 |
|--|--|
| Net income   | \$199.6                                    |
| Interest expense, net  | 84.9                                       |
| Income taxes   | 88.0                                       |
| Depreciation and amortization  | 85.2                                       |
| EBITDA   | \$457.7                                    |
| Adjustments  |  |
| Customer termination charges <sup>(1)</sup>                              | 34.3                                       |
| Restructuring costs <sup>(2)</sup>                                       | 7.8  |
| Adjusted EBITDA  | \$499.8                                    |
| Consolidated funded debt less qualified cash                             | \$1,867.7                                  |
| Ratio of consolidated funded debt less qualified cash to adjusted EBITDA | 3.74 times                                 |

Adjusted EBITDA excludes \$34.3 million of charges related to the termination of the relationship with Mattress Firm. This amount represents the \$25.9 million of net charges and adds the net amortization impact of \$8.4 million of stock-based compensation benefit incurred in the first quarter of 2017.

(2)Restructuring costs represents costs associated with headcount reduction and store closures.

Under our 2016 Credit Agreement, adjusted EBITDA contains certain restrictions that limit adjustments to GAAP net income when calculating adjusted EBITDA. For the twelve months ended June 30, 2017 and 2016, our adjustments to GAAP net income when calculating adjusted EBITDA did not exceed the allowable amount under the 2016 Credit Agreement.

The ratio of adjusted EBITDA under our 2016 Credit Agreement to consolidated funded debt less qualified cash is 3.74 times for the trailing twelve months ended June 30, 2017. Our 2016 Credit Agreement requires us to maintain a ratio of consolidated funded debt less qualified cash to adjusted EBITDA of less than 5.00:1.00 times.



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The following table sets forth the reconciliation of our reported total debt to the calculation of consolidated funded debt less qualified cash as of June 30, 2017. "Consolidated funded debt" and "qualified cash" are terms used in our 2016 Credit Agreement for purposes of certain financial covenants.

|   |                  |
|---|------------------|
| (in millions)                                 | June 30,<br>2017 |
| Total debt, net                               | \$1,861.6        |
| Plus: Deferred financing costs <sup>(1)</sup> | 12.2             |
| Total debt                                    | 1,873.8          |
| Plus: Letters of credit outstanding           | 22.9             |
| Consolidated funded debt                      | \$1,896.7        |
| Less:   |                  |
| Domestic qualified cash <sup>(2)</sup>        | 14.9             |
| Foreign qualified cash <sup>(2)</sup>         | 14.1             |
| Consolidated funded debt less qualified cash  | \$1,867.7        |

The Company presents deferred financing costs as a direct reduction from the carrying amount of the related debt in the Condensed Consolidated Balance Sheets. For purposes of determining total debt for financial covenant

(1) purposes, the Company has added these costs back to total debt, net as calculated per the Condensed Consolidated Balance Sheets.

(2) Qualified cash as defined in the 2016 Credit Agreement equals 100.0% of unrestricted domestic cash plus 60.0% of unrestricted foreign cash. For purposes of calculating leverage ratios, qualified cash is capped at \$150.0 million.

The following table sets forth the reconciliation of our net cash from operating activities to free cash flow for the six months ended and trailing twelve months ended June 30, 2017 and 2016:

| (in millions)  | Six Months Ended June 30, |        | Trailing Twelve Months Ended June 30, |         |
|--|---------------------------|--------|---------------------------------------|---------|
|  | 2017                      | 2016   | 2017                                  | 2016    |
| Net cash provided by operating activities            | \$75.2                    | \$51.9 | \$188.8                               | \$285.0 |
| Subtract: Purchases of property, plant and equipment | 25.9                      | 24.3   | 64.0                                  | 56.2    |
| Free cash flow                                       | \$49.3                    | \$27.6 | \$124.8                               | \$228.8 |

## Stockholders' Equity

## Share Repurchase Program

In February 2017, the Board authorized a \$200.0 million increase in the existing share repurchase authorization for repurchases of Tempur Sealy International's common stock. During the first quarter of 2017, we repurchased 0.6 million shares for approximately \$40.1 million. We did not repurchase any shares during the second quarter of 2017 under this program. As of June 30, 2017, we had approximately \$226.9 million remaining under the existing share repurchase authorization. For a complete description of our Share Repurchase Program, please refer to our Annual Report on Form 10-K, including "Stockholders' Equity" included in ITEM 7 of Part II of the Annual Report.

## Future Liquidity Sources and Uses

Our primary sources of liquidity are cash flows from operations and borrowings under our debt facilities. We expect that ongoing requirements for debt service and capital expenditures will be funded from these sources. As of June 30, 2017, we had \$1,873.8 million in total debt outstanding, and our adjusted EBITDA, which is a non-GAAP financial measure, was \$85.8 million for the three months ended June 30, 2017. Our debt service obligations could, under

certain circumstances, have material consequences to our security holders. Total cash interest payments related to our borrowings are expected to be approximately \$85.0 to \$90.0 million in 2017.

On April 12, 2017, we entered into a securitization transaction with respect to certain accounts receivable. In connection with this transaction, we entered into a credit agreement that provides for revolving loans to be made from time to time in a maximum amount that varies over the course of the year based on seasonality subject to an overall limit of \$120.0 million. The revolving loans bear interest at a floating rate equal to a one month LIBOR index plus 80 basis points.

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Based upon the current level of operations, we believe that cash generated from operations and amounts available under our credit facilities will be adequate to meet our anticipated debt service requirements, capital expenditures 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 our debt facilities or otherwise enable us to service our indebtedness or to make anticipated capital expenditures.

At June 30, 2017, total cash and cash equivalents were \$38.5 million, of which \$14.9 million was held in the U.S. and \$23.6 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 major foreign currencies, or the U.S. Dollar, is not material to our overall liquidity or financial position.

### Contractual Obligations

On April 12, 2017, we entered into a securitization transaction with respect to certain accounts receivable. In connection with this transaction, we entered into a credit agreement that provides for revolving loans to be made from time to time in a maximum amount that varies over the course of the year based on seasonality subject to an overall limit of \$120.0 million. The revolving loans bear interest at a floating rate equal to a one month LIBOR index plus 80 basis points.

Our obligations under the securitization transaction are secured by the accounts receivable and certain related rights and contain customary events of default. We continue to own the accounts receivable, which continue to be reflected as assets on our Condensed Consolidated Balance Sheets. Borrowings under this facility are classified as long-term debt within the Condensed Consolidated Balance Sheets. This credit agreement matures on April 12, 2019. As of June 30, 2017, the amount outstanding under this facility was \$60.1 million.

### Critical Accounting Policies and Estimates

For a discussion of our critical accounting policies and estimates, please refer to ITEM 7 under Part II, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2016. There have been no material changes to our critical accounting policies and estimates in 2017, other than Goodwill and Indefinite-Lived Intangible Assets discussed below.

### Goodwill and Indefinite-Lived Intangible Assets

Goodwill and indefinite-lived intangible assets are evaluated for impairment annually as of October 1 and whenever events or circumstances make it more likely than not that impairment may have occurred.

We test goodwill for impairment by comparing the book values to the fair value at the reporting unit level. Our reporting units are our North America and International segments. We test individual indefinite-lived intangible assets by comparing the book value of each asset to the estimated fair value. 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 measure the impairment loss.

The fair value of each reporting unit is determined by using an income approach, which uses a discounted cash flow approach and a market approach. The fair value of each indefinite-lived intangible asset is determined using an income approach. Significant management judgment is necessary to evaluate the impact of operating and macroeconomic changes on each reporting unit. The significant estimates and assumptions include projected sales growth, gross profit rates, selling, general and administrative rates, working capital requirements, capital expenditures and terminal growth rates, discount rates per reporting unit and the selection of peer company multiples. We

determine discount rates separately for each reporting unit using the weighted average cost of capital, which includes a calculation of cost of equity, which is developed using the capital asset pricing model and comparable company betas (a measure of systemic risk) and cost of debt. We also use comparable market earnings multiple data and our market capitalization to corroborate our reporting unit valuations.

We have not made any material changes in our reporting units or the accounting methodology we use to assess impairment loss on goodwill and indefinite-lived intangible assets since December 31, 2016.

On January 30, 2017, we agreed to terminate our relationship with Mattress Firm effective April 3, 2017. Mattress Firm is a customer within the North America segment and was our largest customer for 2016 and the first quarter of 2017. We conducted an interim impairment analysis on our North America reporting unit and indefinite-lived intangible assets during the first quarter of 2017, which indicated that the fair values of the North America reporting unit and indefinite-lived intangible assets remained

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substantially in excess of their carrying values. Despite that excess, however, impairment charges could still be required in the future if other significant economic events occur or our assumptions on how quickly we can recapture market share and net sales following the termination of our Mattress Firm relationship do not meet our current expectations. No additional impairment indicators were identified during the three months ended June 30, 2017.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Foreign Currency Exposures

We manage a portion of our exposure in foreign currency transactions through the use of foreign exchange forward contracts. Refer to Note 1, "Summary of Significant Accounting Policies," to the accompanying consolidated financial statements for a summary of our foreign exchange forward contracts as of June 30, 2017.

As a result of our global operations, our earnings are exposed to changes in foreign currency exchange rates. Many of our foreign businesses operate in functional currencies other than the U.S. dollar. If the U.S. dollar strengthened relative to the euro or other foreign currencies where we have operations, there would be a negative impact on our operating results upon translation of those foreign operating results into the U.S. dollar. Foreign currency exchange rate changes negatively impacted our adjusted EBITDA, which is a non-GAAP financial measure, by approximately 2.1% and 2.2% in the three and six months ended June 30, 2017, respectively. We do not hedge the translation of foreign currency operating results into the U.S. dollar.

We hedge a portion of our currency exchange exposure relating to foreign currency transactions with foreign exchange forward contracts. A sensitivity analysis indicates the potential loss in fair value on foreign exchange forward contracts outstanding at June 30, 2017, resulting from a hypothetical 10.0% adverse change in all foreign currency exchange rates against the U.S. dollar, is approximately \$3.3 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 exchange forward contracts.

#### Interest Rate Risk

On June 30, 2017, we had variable-rate debt of approximately \$717.1 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 of approximately \$7.2 million. We continue to evaluate the interest rate environment and look for opportunities to improve our debt structure and minimize interest rate risk and expense.

### ITEM 4. 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 June 30, 2017, 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 Securities and Exchange Commission's ("SEC") rules and forms 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.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that was conducted during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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See Note 8, "Commitments and Contingencies," in the "Notes to Condensed Consolidated Financial Statements," in ITEM 1 under Part I of this Report for a description of certain legal proceedings.

We are involved in various other legal proceedings incidental to the operations of our business. We believe that the outcome of all such pending other legal proceedings in the aggregate will not have a material adverse effect on our business, financial condition, liquidity or operating results.

## ITEM 1A. RISK FACTORS

None.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable.

(b) Not applicable.

(c) Issuer Purchases of Equity Securities

The following table sets forth purchases of our common stock for the three months ended June 30, 2017:

| Period                         | (a) Total number of shares 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) |
|--------------------------------|--------------------------------------|----------------------------------|--|--|
| April 1, 2017 - April 30, 2017 | —                                    | \$—                              | —  | \$226.9  |
| May 1, 2017 - May 31, 2017     | 4,256                                | (1) \$47.47                      | —  | \$226.9  |
| June 1, 2017 - June 30, 2017   | 1,489                                | (1) \$48.08                      | —  | \$226.9  |
| Total                          | 5,745                                |                                  | —  |  |

Includes shares withheld upon the vesting of certain equity awards to satisfy tax withholding obligations. The (1) shares withheld were valued at the closing price of the common stock on the New York Stock Exchange on the vesting date or prior business day.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

(a) Not applicable.

(b) Not applicable.

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ITEM 6. EXHIBITS

The following is an index of the exhibits included in this report:

- 10.1 Credit and Security Agreement, dated as of April 12, 2017 among Tempur Sealy Receivables, LLC, as borrower, Tempur Sealy International, Inc., as master servicer, and Wells Fargo Bank, National Association, as lender. (Incorporated by reference from Exhibit 10.1 of the Company's Current Report on Form 8-K dated April 18, 2017).
- 10.2 Receivables Sale and Contribution Agreement, dated as of April 12, 2017, between Tempur-Pedic North America, LLC, as seller and contributor, and Tempur Sealy Receivables, LLC, as purchaser and contributee. (Incorporated by reference from Exhibit 10.2 of the Company's Current Report on Form 8-K dated April 18, 2017).
- 10.3 Receivables Sale Agreement, dated as of April 12, 2017, between Sealy Mattress Manufacturing Company, LLC, as seller, and Tempur-Pedic North America, LLC, as purchaser. (Incorporated by reference from Exhibit 10.3 of the Company's Current Report on Form 8-K dated April 18, 2017).
- 10.4 Tempur Sealy International, Inc. Amended and Restated 2013 Equity Incentive Plan. (Incorporated by reference from Exhibit 99.1 of the Company's Current Report on Form 8-K dated May 2, 2017).
- 10.5 Tempur Sealy International, Inc. Amended and Restated Long-Term Incentive Plan. (Incorporated by reference from Exhibit 10.1 of the Company's Current Report on Form 8-K dated July 26, 2017).
- 10.6 Non-Disclosure and Standstill Agreement, dated as of June 26, 2017, by and among Tempur Sealy International, Inc., Usman Nabi, H Partners Management, LLC and the other parties named therein. (Incorporated by reference from Exhibit 10.1 of the Company's Current Report on Form 8-K dated June 28, 2017).
- 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.
- 101.0 The following materials from Tempur Sealy International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Income, (ii) the Condensed Consolidated Statements of Comprehensive Income, (iii) the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) the Notes to Condensed Consolidated Financial Statements.

(1) Incorporated by reference.

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

This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78r), 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, as amended, or the Securities Exchange Act of 1934, as amended, 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 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 SEALY INTERNATIONAL, INC.

Date: August 3, 2017 By: /s/ BARRY A. HYTINEN

Barry A. Hytinen

Executive Vice President and Chief Financial Officer