TEMPUR SEALY INTERNATIONAL, INC.
Form 10-Q
August 01, 2014

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

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2014
o 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 ý No o

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).
ý Yes o No

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of the registrant’s common stock as of July 31, 2014 was 60,906,011 shares.

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Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including the information incorporated by reference herein, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which includes information concerning our plans; objectives; goals; strategies; future events; future revenues or performance; the impact of the macroeconomic environment in both the U.S. and internationally on sales and our business segments; strategic long-term investments; changes in capital expenditures; consumer confidence and the availability of consumer financing; changes in interest rates; litigation and similar issues; changes in foreign tax rates and changes in tax laws generally, including the ability to utilize tax loss carry forwards; the outcome of pending tax audits or other tax proceedings; financial flexibility; the impact of initiatives to respond to increased levels of competition in our industry; the impact of initiatives to accelerate growth, expand global market share and sales; efforts to expand business within established accounts, improve account productivity, reduce costs and operating expenses and improve manufacturing productivity; changing commodity costs; initiatives to improve gross margin; the vertical integration of our business; the development, rollout and market acceptance of new products; the efficiency and effectiveness of our advertising campaigns and other marketing programs; our ability to further invest in the business and in brand awareness; our ability to meet financial obligations and continue to comply with the terms of our credit facilities, including financial ratio covenants; effects of changes in foreign exchange rates on our reported earnings; our expected sources of cash flow; our ability to effectively manage cash; our ability to align costs with sales expectations; and our ability to successfully integrate Sealy Corporation ("Sealy") into the Company's operations and realize cost and revenue synergies and other benefits from the transaction, including expectations regarding product offerings, growth opportunities, value creation, and financial strength. Many of these statements appear, in particular, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in ITEM 2 of Part I of this report. When used in this report, the words "estimates," "expects," "anticipates," "projects," "proposed," "plans," "intends," "believes" and variations of such w similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon our current expectations and various assumptions. There can be no assurance that we will realize our expectations or that our beliefs will prove correct.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. There are 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 1 of our Annual Report on Form 10-K for the year ended December 31, 2013. 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.

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ITEM 1. FINANCIAL STATEMENTS
TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per common share amounts)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net sales	$715.0	$660.6	$1,416.9	$1,050.7
Cost of sales	446.7	405.7	879.1	607.4
Gross profit	268.3	254.9	537.8	443.3
Selling and marketing expenses	155.2	139.8	298.2	226.2
General, administrative and other	69.5	76.3	139.8	135.0
Equity income in earnings of unconsolidated affiliates	(2.1)	(1.1)	(3.8)	(1.3)
Royalty income, net of royalty expense	(4.6)	(4.1)	(9.1)	(5.1)
Operating income	50.3	44.0	112.7	88.5
Other expense, net:				
Interest expense, net	23.0	35.7	45.2	63.6
Loss on disposal of business	20.4	—	20.4	—
Other (income) expense, net	(0.5)	1.6	0.5	3.1
Total other expense	42.9	37.3	66.1	66.7
Income before income taxes	7.4	6.7	46.6	21.8
Income tax provision	(9.8)	(8.8)	(21.3)	(11.4)
Net (loss) income before non-controlling interest	(2.4)	(2.1)	25.3	10.4
Less: Net (loss) income attributable to non-controlling interest	(0.2)	(0.5)	0.1	(0.5)
Net (loss) income attributable to Tempur Sealy International, Inc.	$(2.2)	$(1.6)	$25.2	$10.9
(Loss) earnings per common share:				
Basic	$(0.04)	$(0.03)	$0.41	$0.18
Diluted	$(0.04)	$(0.03)	$0.41	$0.18
Weighted average common shares outstanding:				
Basic	60.8	60.4	60.8	60.2
Diluted	60.8	60.4	61.9	61.5

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 Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net (loss) income before non-controlling interest	$(2.4)	$(2.1)	$25.3	$10.4
Other comprehensive income (loss) before tax, net of tax				
Foreign currency translation adjustments	3.4	(6.6)	4.2	(17.7)
Net change in unrecognized gain on interest rate swap, net of tax	0.1	0.7	0.2	1.1
Pension benefits, net of tax	0.3	—	0.3	—
Unrealized loss on cash flow hedging derivatives, net of tax	(1.7)	—	(0.8)	—
Other comprehensive income (loss), net of tax	2.1	(5.9)	3.9	(16.6)
Comprehensive (loss) income	(0.3)	(8.0)	29.2	(6.2)
Less: Comprehensive (loss) income attributable to non-controlling interest	(0.2)	(0.5)	0.1	(0.5)
Comprehensive (loss) income attributable to Tempur Sealy International, Inc.	$(0.1)	$(7.5)	$29.1	$(5.7)

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, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$121.5	$ 81.0
Accounts receivable, net	376.2	349.2
Inventories	220.0	199.2
Prepaid expenses and other current assets	54.9	53.7
Deferred income taxes	45.4	44.4
Total Current Assets	818.0	727.5
Property, plant and equipment, net	366.4	411.6
Goodwill	741.5	759.6
Other intangible assets, net	743.5	750.1
Deferred income taxes	11.0	10.9
Other non-current assets	71.5	70.2
Total Assets	$2,751.9	$ 2,729.9
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current Liabilities:		
Accounts payable	$235.2	$ 191.2
Accrued expenses and other current liabilities	205.0	208.4
Deferred income taxes	0.9	0.8
Income taxes payable	17.3	1.5
Current portion of long-term debt	52.8	39.6
Total Current Liabilities	511.2	441.5
Long-term debt	1,723.2	1,796.9
Deferred income taxes	268.4	286.1
Other non-current liabilities	81.6	75.3
Total Liabilities	2,584.4	2,599.8
Commitments and contingencies—see Note 13		
Redeemable non-controlling interest	11.6	11.5
Total Stockholders’ Equity	155.9	118.6
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	$2,751.9	$ 2,729.9

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 Ended June 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income before non-controlling interest	$25.3	$10.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40.1	31.4
Amortization of stock-based compensation	5.4	8.2
Amortization of deferred financing costs	4.6	2.7
Write-off of deferred financing costs	—	4.7
Bad debt expense	3.9	(0.5)
Deferred income taxes	(17.0)	(51.6)
Equity income in earnings of unconsolidated affiliates	(3.8)	(1.3)
Non-cash interest expense on convertible notes	2.5	1.3
Loss on sale of assets	—	0.2
Foreign currency adjustments and other	0.1	0.7
Loss on disposal of business	20.4	—
Changes in operating assets and liabilities, net of effect of business acquisitions	(9.1)	(18.2)
Net cash provided by (used in) operating activities	72.4	(11.5)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of businesses, net of cash acquired	—	(1,172.9)
Proceeds from disposition of business	46.3	—
Purchases of property, plant and equipment	(16.9)	(19.3)
Other	(2.1)	2.1
Net cash provided by (used in) investing activities	27.3	(1,190.1)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from 2012 Credit Agreement	106.5	2,368.8
Repayments of 2012 Credit Agreement	(169.1)	(926.6)
Proceeds from issuance of Senior Notes	—	375.0
Proceeds from 2011 Credit Facility	—	46.5
Repayments of 2011 Credit Facility	—	(696.5)
Proceeds from exercise of stock options	3.5	5.5
Excess tax benefit from stock based compensation	1.5	3.5
Treasury shares repurchased	(2.2)	—
Payments of deferred financing costs	—	(51.9)
Other	0.2	(0.2)
Net cash (used in) provided by financing activities	(59.6)	1,124.1
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	0.4	(0.4)
Increase (decrease) in cash and cash equivalents	40.5	(77.9)
CASH AND CASH EQUIVALENTS, beginning of period	81.0	179.3
CASH AND CASH EQUIVALENTS, end of period	$121.5	$101.4

Supplemental cash flow information:		
Cash paid during the period for:		
Interest	$38.2	$52.3
Income taxes, net of refunds	21.3	26.8

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. Additionally, the Company participates in several joint ventures in the Asia-Pacific region as well as a joint venture in the U.S. with Comfort Revolution International, LLC ("Comfort Revolution"). The Company sells its products through three sales channels: Retail, Direct and Other.

On March 18, 2013, the Company completed the acquisition of Sealy Corporation and its historical subsidiaries (“Sealy”), which manufactures and markets a broad range of mattresses and foundations. The Company’s acquisition of Sealy ("Sealy Acquisition") is more fully described in Note 3, “Acquisition and Divestiture”. The 2014 and 2013 results of operations for Sealy are reported within the Company’s Sealy reportable segment and include results for the three months and six months ended June 30, 2014 and March 18, 2013 through June 30, 2013, respectively.

As a result of the Sealy Acquisition, the Company’s Condensed Consolidated Financial Statements include the results of Comfort Revolution, a 45.0% owned joint venture. Comfort Revolution constitutes a variable interest entity (“VIE”) 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 that were considered in the related-party analysis surrounding the identification of the primary beneficiary. 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, as a result of the Sealy Acquisition, to develop markets for Sealy® branded products in those regions. The equity method of accounting is used for these joint ventures over which the Company has significant influence, but does not have effective control, and consolidation is not otherwise required. The Company’s Asia-Pacific joint ventures are more fully described in Note 6, “Unconsolidated Affiliate Companies”.

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, 2013, included in the Company’s Annual Report on Form 10-K filed on February 21, 2014.

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:

(in millions)	June 30, 2014	December 31, 2013
Finished goods	$148.6	$126.7
Work-in-process	12.3	10.0
Raw materials and supplies	59.1	62.5
	$220.0	$199.2

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(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.

The Company had the following activity for sales returns from December 31, 2013 to June 30, 2014:

(in millions)	
Balance as of December 31, 2013	$28.7
Amounts accrued	63.4
Returns charged to accrual	(61.8)
Balance as of June 30, 2014	$30.3

(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 following summarizes the Company's warranty terms:

Segment	Product/Brand	Warranty Term (in years)
Tempur North America	Mattresses	10 - 25, prorated (1)
Tempur North America	Pillows	3
Tempur International	Mattresses	15, prorated (2)
Tempur International	Pillows	3
Sealy	Mattresses	10 - 25, prorated(1)

(1) Products have various warranty terms, generally non-prorated for the first 10 to 15 years and then prorated for the balance of the warranty term.

(2) The last 10 years of warranty period are prorated on a straight-line basis.

The Company had the following activity for warranties from December 31, 2013 to June 30, 2014:

(in millions)	
Balance as of December 31, 2013	$26.1
Amounts accrued	17.2
Warranties charged to accrual	(13.9)
Balance as of June 30, 2014	$29.4

As of June 30, 2014 and December 31, 2013, $17.8 million and $14.9 million are included as a component of accrued expenses and other current liabilities and $11.6 million and $11.2 million are included in other non-current liabilities on the Company's accompanying Condensed Consolidated Balance Sheets, respectively. In estimating its warranty obligations, the Company considers the impact of recoverable salvage value on warranty costs by segment in determining its estimate of future warranty obligations.

(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. The Company also reports sales net of tax assessed by qualifying governmental authorities. The Company extends credit based on the creditworthiness of its customers. No collateral is required on sales made in the normal course of business.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

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 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 $22.6 million and $19.3 million as of June 30, 2014 and December 31, 2013, respectively.

(f) Research and Development Expenses. Research and development expenses for new products are expensed as they are incurred and included in general, administrative and other expenses in the accompanying Condensed Consolidated Statements of Operations. Research and development costs charged to expense were $5.5 million and $4.6 million for the three months ended June 30, 2014 and 2013, respectively. Research and development costs charged to expense were $11.3 million and $9.4 million for the six months ended June 30, 2014 and 2013, respectively.

(g) Royalty Income and Expense. The Company recognizes royalty income based on sales of Sealy® and Stearns & Foster® branded products by various licensees. The Company also pays royalties to other entities for the use of their names on products produced by the Company. Royalty income, net of royalty expense, was $4.6 million and $4.1 million for the three months ended June 30, 2014 and 2013, respectively. Royalty income, net of royalty expense, was $9.1 million and $5.1 million for the six months ended June 30, 2014 and 2013, respectively.

(h) Environmental Cost. Environmental expenditures that relate to current operations are expensed or capitalized, as appropriate, under the Financial Accounting Standards Board ("FASB") authoritative guidance on environmental remediation liabilities. Expenditures that relate to an existing condition caused by past operations and that do not provide future benefits are expensed as incurred. Liabilities are recorded when environmental assessments are made or the requirement for remedial efforts is probable, and the costs can be reasonably estimated. The timing of accruing for these remediation liabilities is generally no later than the completion of feasibility studies. The Company has an ongoing monitoring and identification process to assess how the activities, with respect to the known exposures, are progressing against the accrued cost estimates, as well as to identify other potential remediation sites that are presently unknown.

(i) Pension Obligations. The Company has a noncontributory, defined benefit pension plan covering current and former hourly employees at three of its active Sealy U.S. plants, eight previously closed Sealy U.S. facilities and one of the Sealy U.S. innerspring components facilities recently sold. Sealy Canada, Ltd. (a 100.0% owned subsidiary of the Company) also sponsors a noncontributory, defined benefit pension plan covering hourly employees at one of its facilities. Both plans provide retirement and survivorship benefits based on the employees' credited years of service. The Company's funding policy provides for contributions of an amount between the minimum required and maximum amount that can be deducted for federal income tax purposes. The funded status is measured as the difference between the fair value of plan assets and the benefit obligation at December 31, the measurement date. The benefit obligation is the projected benefit obligation (“PBO”). The PBO represents the actuarial present value of benefits expected to be paid upon retirement based on estimated future compensation levels. The fair value of plan assets represents the current market value of assets held by an irrevocable trust fund for the sole benefit of participants. The measurement of the PBO is based on the Company’s estimates and actuarial valuations. These valuations reflect the terms of the plans and use participant-specific information such as compensation, age and years of service, as well as certain assumptions that require significant judgment, including estimates of discount rates, expected return on plan assets, rate of compensation increases, interest crediting rates and mortality rates.

(j) Reclassifications. The Company has reclassified certain prior-period amounts in the Condensed Consolidated Statements of Cash Flows to conform to current period presentation. The reclassifications were not material and do not materially impact previously reported subtotals within the Condensed Consolidated Financial Statements for any period presented.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(2) Recently Issued Accounting Pronouncements

In May 2014, the 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. The 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. Entities have the option of using either a full retrospective or a modified retrospective approach for the adoption of the new standard. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the Company's adoption method and the impact it will have on the Company's Condensed Consolidated Financial Statements.
(3) Acquisition and Divestiture
Sealy Acquisition

On March 18, 2013, the Company completed the Sealy Acquisition. Pursuant to the merger agreement, each share of common stock of Sealy issued and outstanding immediately prior to the effective time of the Sealy Acquisition was canceled and (other than shares held by Sealy or Tempur-Pedic or their subsidiaries or Sealy stockholders who properly exercised their appraisal rights) converted into the right to receive $2.20 in cash. The total purchase price was $1,172.9 million, which was funded using available cash and financing consisting of the Company’s 2012 Credit Agreement and Senior Notes (see Note 5, “Debt” for the definition of these terms and further discussion).

Sealy owns one of the largest portfolios of bedding brands in the world, and manufactures and markets a complete line of bedding products under the Sealy®, Sealy Posturepedic®, Optimum™ and Stearns & Foster® brands. The results of operations of Sealy and Sealy’s historical subsidiaries are reported within the Company’s Sealy reportable segment.

The Company incurred $5.4 million and $17.2 million of direct transaction expenses for the three and six months ended June 30, 2013. These expenses are included in general, administrative and other expenses in the accompanying Condensed Consolidated Statements of Operations. In addition, the Company incurred $19.9 million of incremental interest expense for the six months ended June 30, 2013, which includes interest and other fees on the Senior Notes and the 2012 Credit Agreement for the period prior to March 18, 2013, commitment fees associated with financing for the closing of the Sealy Acquisition, and the write off of deferred financing costs associated with the 2011 Credit Facility.

The Company accounted for the Sealy Acquisition using the acquisition method. The allocation of the purchase price is based on estimates of the fair value of assets acquired and liabilities assumed as of March 18, 2013. The components of the final purchase price allocation are as follows:

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(in millions)	
Accounts receivable	$185.0
Inventory	75.1
Prepaid expenses and other current assets	23.4
Accounts payable	(77.9)
Accrued expenses	(140.0)
Property, plant and equipment	242.1
Other assets	32.6
Identifiable intangible assets:	
Indefinite-lived trade names	521.2
Contractual retailer/distributer relationships	91.1
Developed technology, including patents	87.1
Customer databases	3.9
Optimum™ trade name	2.3
Deferred income taxes, net	(231.2)
Sealy 8.0% Notes	(96.2)
Redeemable non-controlling interest	(11.3)
Other liabilities	(77.5)
Goodwill	543.2
Net consideration transferred	$1,172.9

The excess of the purchase price over the estimated fair value of the tangible net assets and identifiable intangible assets acquired was recorded as goodwill. The factors contributing to the recognition of the amount of goodwill are based on several strategic and synergistic benefits that are expected to be realized from the Sealy Acquisition. These benefits include a comprehensive portfolio of iconic brands, complementary product offerings, enhanced global footprint, and attractive synergy opportunities and value creation. None of the goodwill is expected to be deductible for income tax purposes and is entirely allocated to the Sealy reportable segment.

The following unaudited pro forma information presents the combined financial results for the Company and Sealy as if the Sealy Acquisition had been completed at the beginning of the Company's prior year, January 1, 2013. Prior to the Sealy Acquisition, Sealy used a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The pro forma information set forth below for the three months ended June 30, 2013 includes Sealy's pro forma information for the quarterly periods April 1, 2013 through June 30, 2013. The pro forma financial information set forth below for the six months ended June 30, 2013 includes Sealy's pro forma information for the combined six month period from December 3, 2012 through March 3, 2013 and April 1, 2013 through June 30, 2013.

(in millions, except earnings per common share)	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net sales	$1,416.9	$1,343.6
Net income	$25.2	$19.1
Earnings per common share – Diluted	$0.41	$0.31

The information above does not include the pro forma adjustments that would be required under Regulation S-X for pro forma financial information. Therefore, the information is not necessarily indicative of results that would have been achieved had the businesses been combined during the periods presented or the results that the Company will experience going forward.

Disposal of Innerspring Component Production Facilities and Associated Equipment

Effective June 30, 2014, the Company completed the sale of its three U.S. innerspring component production facilities and equipment, along with associated working capital, to Leggett & Platt (“L&P”) for total consideration of approximately $47.8 million, subject to customary working capital adjustments, which included $1.5 million of other non-cash consideration. The carrying amount of the net assets sold in this transaction was approximately $66.8 million, including an allocation of goodwill within the Sealy segment which was determined using the relative fair value method. As a result, a loss on disposal of business was recorded for $20.4 million, which included $1.4 million of transaction costs. In connection with the disposal, the Company entered into a long-term supply arrangement with L&P at fair value prices. With the supply arrangement in place, the operations prior to the disposition do not qualify as discontinued operations.

(4) Goodwill and Other intangible assets

The following summarizes changes to the Company’s goodwill, by reportable business segment:

(in millions)	Total	Tempur North America	Tempur International	Sealy
Balance as of December 31, 2013	$759.6	$107.7	$107.3	$544.6
Disposal of business	(21.4)	—	—	(21.4)
Foreign currency translation adjustments and other	3.3	(0.1)	0.3	3.1
Balance as of June 30, 2014	$741.5	$107.6	$107.6	$526.3

The following table summarizes information relating to the Company’s other intangible assets, net:

		June 30, 2014			December 31, 2013		
($ in millions)	Useful Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Unamortized indefinite life intangible assets:							
Trade names		$575.1	$—	$575.1	$575.3	$—	$575.3
Amortized intangible assets:							
Contractual distributor relationships	15	$89.8	$7.7	$82.1	$90.0	$4.7	$85.3
Technology and other	4-10	93.8	29.2	64.6	93.2	25.5	67.7
Patents, other trademarks, & other trade names	5-20	27.5	13.4	14.1	27.4	12.2	15.2
Customer databases, relationships, and reacquired rights	5	23.4	15.8	7.6	21.0	14.4	6.6
Total		$809.6	$66.1	$743.5	$806.9	$56.8	$750.1

Amortization expense relating to intangible assets for the Company was $4.7 million and $4.6 million for the three months ended June 30, 2014 and 2013, respectively. Amortization expense relating to intangible assets for the Company was $9.1 million and $6.2 million for the six months ended June 30, 2014 and 2013, respectively. No impairments of goodwill or other intangible assets have adjusted the gross carrying amount of these assets in any historical period.

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(5) Debt

Debt. Debt for the Company consists of the following:

(in millions)	June 30, 2014	December 31, 2013
Debt:		
Revolving credit facility, interest at Base Rate plus applicable margin of 2.25% or LIBOR plus applicable margin of 3.25% as of June 30, 2014 and as of December 31, 2013, commitment through and due March 18, 2018	$51.0	$74.5
Term A Facility, interest at LIBOR plus applicable margin of 2.50% as of June 30, 2014 and as of December 31, 2013, commitment through and due March 18, 2018	499.9	522.5
Term B Facility, interest at LIBOR, subject to a 0.75% floor plus applicable margin of 2.75% as of June 30, 2014 and as of December 31, 2013, commitment through and due March 18, 2020	720.8	737.3
$375.0 million Senior Notes, interest at 6.875%, due December 15, 2020	375.0	375.0
8.0% Sealy Notes, due July 15, 2016	102.1	99.6
Capital lease obligations and other	27.2	27.6
	$1,776.0	$1,836.5
Less: current portion	(52.8)	(39.6)
Long-term debt	$1,723.2	$1,796.9

2012 Credit Agreement

On December 12, 2012, Tempur Sealy International and certain subsidiaries of Tempur Sealy International as borrowers and guarantors, entered into a credit agreement (the “2012 Credit Agreement”) with a syndicate of banks. The 2012 Credit Agreement initially provided for (i) a revolving credit facility of $350.0 million (the “Revolver”), (ii) a term A facility of $550.0 million (the “Term A Facility”) and (iii) a term B facility of $870.0 million (the “Term B Facility”).

Borrowings under the Revolver bear interest at either (i) LIBOR plus applicable margin, or (ii) Base Rate plus applicable margin. As of June 30, 2014, the Revolver total LIBOR plus applicable margin interest rate was 3.40%. As of June 30, 2014, the Revolver total Base Rate plus applicable margin interest rate was 5.50%. The Revolver will mature on March 18, 2018. During the six months ended June 30, 2014, borrowings were $106.5 million and repayments were $130.0 million. Total outstanding borrowings under the Revolver were $51.0 million with letters of credit outstanding of $17.5 million, and total availability under the Revolver was $281.5 million as of June 30, 2014.

The Term A Facility bears interest at LIBOR plus applicable margin. As of June 30, 2014, the Term A Facility total LIBOR plus applicable margin interest rate was 2.65%. The Term A Facility will mature on March 18, 2018, and is subject to scheduled quarterly payments in accordance with the 2012 Credit Agreement. The scheduled quarterly payments are $6.8 million through December 31, 2014, and $13.5 million from March 31, 2015 through December 31, 2017. Upon maturity, the principal payment due is $324.3 million. During the six months ended June 30, 2014, repayments were $22.6 million, which includes $9.1 million of prepayments made as a result of the excess cash flow covenant in the 2012 Credit Agreement.

The Term B Facility bears interest at LIBOR, subject to a 0.75% floor, plus applicable margin. As of June 30, 2014, the Term B Facility total LIBOR plus applicable margin was 3.50%. The Term B Facility will mature on March 18, 2020, and is subject to scheduled quarterly payments in accordance with the 2012 Credit Agreement. The scheduled quarterly payments are $1.8 million through December 31, 2019. Upon maturity, the principal payment due is $680.6 million. During six months ended June 30, 2014, repayments were $16.5 million, which includes $12.8 million of prepayments made as a result of the excess cash flow covenant in the 2012 Credit Agreement.

The 2012 Credit Agreement requires compliance with certain financial covenants providing for maintenance of a minimum consolidated interest coverage ratio and maintenance of a maximum consolidated total 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 certain other debt and obligations. The Company is allowed to exclude 100.0% of the 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, 2014, domestic qualified cash was $80.9 million and foreign qualified cash was $24.4 million

The Company is in compliance with all applicable covenants as of June 30, 2014.

Senior Notes

On December 19, 2012, Tempur Sealy International issued $375.0 million aggregate principal amount of 6.875% senior notes due 2020 (the “Senior Notes”) to qualified institutional buyers pursuant to Rule 144A of the Securities Act of 1933, as amended (the “Securities Act”), and to certain non-U.S. persons in accordance with Regulation S under the Securities Act. The Senior Notes were issued pursuant to an indenture, dated as of December 19, 2012 (the “Indenture”), among the Company, certain subsidiaries of Tempur Sealy International as guarantors (the “Guarantors”), and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”). The Senior Notes are general unsecured senior obligations of Tempur Sealy International and are guaranteed on a senior unsecured basis by the Guarantors. The Senior Notes mature on December 15, 2020, and interest is payable semi-annually in arrears on each June 15 and December 15, beginning on June 15, 2013. The gross proceeds from the Senior Notes, were funded into escrow and these funds were released from escrow on March 18, 2013 and used as part of the funding of the Sealy Acquisition. Following the completion of the Sealy Acquisition, Sealy and certain of its subsidiaries became Guarantors of the Senior Notes.

8.0% Sealy Notes

In conjunction with the Sealy Acquisition, Sealy’s obligations under its 8.0% Sealy Notes were amended. As a result of the Sealy Acquisition, the 8.0% Sealy Notes became convertible solely into cash, in an amount that declined slightly every day during the Make-Whole Period (as defined under the Supplemental Indenture governing the 8.0% Sealy Notes) that followed the Sealy Acquisition, and then became fixed thereafter. The Make-Whole Period effectively expired on April 12, 2013. As of April 12, 2013, approximately 83.0% of all the 8.0% Sealy Notes outstanding prior to the Sealy Acquisition were converted into cash and paid to the holders. Holders of the 8.0% Sealy Notes who converted on March 19, 2013 received approximately $2,325.43 per $1,000 Accreted Principal Amount of the 8.0% Sealy Notes being converted. The holders of the 8.0% Sealy Notes who convert after April 12, 2013 will receive $2,200 per $1,000 Accreted Principal Amount of the 8.0% Sealy Notes being converted. The Company calculated the preliminary fair value of the remaining 8.0% Sealy Notes as part of its purchase price allocation by first calculating the future payout of the remaining 17.0% aggregate principal amount of the 8.0% Sealy Notes still outstanding and the cumulative semi-annual interest payments at the July 15, 2016 maturity, and then calculated the present value using a market discount rate, which resulted in a fair value of $96.2 million at the date of the opening balance sheet. As of June 30, 2014, the fair value and carrying value of the 8.0% Sealy Notes is $102.1 million, which includes $6.2 million of accreted discount less conversion payments made to holders of certain 8.0% Sealy Notes that were tendered for conversion. The discount is accreted through non-cash interest expense over the life of the 8.0% Sealy Notes using the effective interest method.

The 8.0% Sealy Notes mature on July 15, 2016 and bear interest at 8.0% per annum accruing semi-annually in arrears on January 15 and July 15 of each year. Sealy does not pay interest in cash to the holders of the 8.0% Sealy Notes, but instead increases the principal amount of the 8.0% Sealy Notes by an amount equal to the accrued interest for the interest period then ended ("Paid-In-Kind" or "PIK interest"). The amount of the accrued interest for each interest period is calculated on the basis of the accreted principal amount as of the first day of such interest period. Any PIK interest accrued with respect to the 8.0% Sealy Notes converted between interest payment dates is forfeited in most circumstances.

All material negative covenants (apart from the lien covenant and related collateral requirements) were eliminated from the supplemental indenture governing the 8.0% Sealy Notes, as well as certain events of default and certain other provisions. In addition, Tempur Sealy International and its non-Sealy subsidiaries do not provide any guarantees of any obligations with respect to the 8.0% Sealy Notes.

Capital Leases

The Company is party to capital leases and has recorded the future obligations on its accompanying Condensed Consolidated Balance Sheets. The approximate remaining life of the leases is between 8 and 10 years.

Interest Rate Swap

On August 8, 2011, the Company entered into a four-year interest rate swap agreement to manage interest costs and the risk associated with changing interest rates associated with variable portions of the Company’s debt outstanding. Refer to Note 7, “Derivative Financial Instruments,” for additional information regarding the Company’s interest rate swap agreement.

(6) Unconsolidated Affiliate Companies

The Company has ownership interests in a group of Asia-Pacific joint ventures, as a result of the Sealy Acquisition, to develop markets for Sealy® branded products in those regions. The Company’s ownership interest in these joint ventures is 50.0% and is accounted for under the equity method. The Company's investment of $10.7 million at June 30, 2014 and $7.8 million at December 31, 2013 are recorded in other non-current assets within the accompanying Condensed Consolidated Balance Sheets. The Company’s share of earnings is recorded in equity income in earnings of unconsolidated affiliates in the accompanying Condensed Consolidated Statements of Operations.

(7) Derivative Financial Instruments

In the normal course of business, the Company is exposed to certain risks related to fluctuations in interest rates and foreign exchange rate risk. The Company uses interest rate swaps to manage risks from interest rate market fluctuations. The financial instruments used by the Company are straight-forward, non-leveraged instruments. The counterparties to these financial instruments are financial institutions with strong credit ratings. The Company maintains control over the size of positions entered into with any one counterparty and regularly monitors the credit ratings of these institutions. The Company also utilizes foreign exchange spot and forward contracts to manage the risk associated with exposures to foreign currency risk. In addition, certain foreign exchange forward contracts relate to risks associated with intercompany inventory purchases and are designated as cash flow hedging instruments. Certain foreign exchange forward contracts relate to intercompany debt and associated interest payments and certain accounts receivable and accounts payable and are considered to be economic hedges. The fair value of foreign exchange forward contracts is calculated as described in Note 8, "Fair Value Measurements," taking into consideration foreign currency rates and the current creditworthiness of the counterparties or the Company, as applicable.

Interest Rate Swap

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

As a result of this swap, the Company pays interest at a fixed rate and receives payments at a variable rate which began on December 30, 2011. As of this date, the swap effectively fixed the floating LIBOR-based interest rate to 1.25% plus the applicable margin on $250.0 million of the outstanding balance under the Company’s variable rate debt. On December 30, 2013, the outstanding notional principal amount of the swap reduced to $150.0 million. The interest rate swap expires on December 30, 2015. The Company has selected the LIBOR-based rate on the hedged portion of the Company’s variable rate debt during the term of the swap. The effective portion of the change in value of the swap is reflected as a component of comprehensive income and recognized as interest expense, net as payments are paid or accrued. The remaining gain or loss in excess of the cumulative change in the present value of the future cash flows of the hedged item, if any (i.e., the ineffective portion) or hedge components excluded from the assessment of effectiveness are recognized as interest expense, net during the current period.

Foreign Exchange Forward Contracts

Cash Flow Hedges

The Company is exposed to foreign currency risk related to intercompany inventory purchases denominated in foreign currencies. To manage the risk associated with fluctuations in foreign currencies related to these transactions, the Company enters into foreign exchange forward contracts. As of June 30, 2014, the Company had foreign exchange forward contracts designated as cash flow hedges to buy Canadian dollars and to sell U.S. dollars with a notional amount outstanding of $51.8 million. These foreign exchange forward contracts have maturities ranging from July 2014 to June 2015. The Company designates certain foreign exchange forward contracts as hedging instruments, and the contracts qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, excluding time value, is assessed prospectively and retrospectively on a monthly basis using regression analysis, as well as using other timing and probability criteria. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of the cash flow hedge contracts' gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income until the underlying hedged item is reflected in the Company's accompanying Condensed Consolidated Statements of Operations, at which time the effective amount in accumulated other comprehensive income is reclassified to cost of sales in accompanying Condensed Consolidated Statements of Operations. The Company expects to reclassify a loss of approximately $0.8 million, net of tax, over the next 12 months based on the June 30, 2014 exchange rate.

In the event that the gains or losses in accumulated other comprehensive income are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to other expense, net on the accompanying Condensed Consolidated Statements of Operations. During the current reporting period, all forecasted transactions occurred and, therefore, there were no such gains or losses reclassified to other expense, net.

Economic Hedges

The Company is also exposed to foreign currency risk related to intercompany debt and associated interest payments and certain 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 foreign currency agreements are estimated as described in Note 8, “Fair Value Measurements,” taking into consideration foreign currency rates and the current creditworthiness of the counterparties or the Company, as applicable. These amounts are immaterial to the Condensed Consolidated Financial Statements.

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As of June 30, 2014 and December 31, 2013, the fair value of the Company's derivative instruments included in the accompanying Condensed Consolidated Balance Sheets were recorded as follows:

(in millions)

	Liability Derivatives Balance Sheet Location	Fair Value	
		June 30, 2014	December 31, 2013
Derivatives designated as hedging instruments			
Interest rate swap - current	Accrued expenses and other current liabilities	$1.5	$1.4
Interest rate swap - non-current	Other non-current liabilities	0.4	0.9
Foreign exchange forward contracts - current	Accrued expenses and other current liabilities	1.2	—
Derivatives not designated as hedging instruments			
Foreign exchange forward contracts - current	Accrued expenses and other current liabilities	0.1	—
		$3.2	$2.3

(8) Fair Value Measurements

The classification of fair value measurements within the established three-level hierarchy is based upon the lowest level of input that is significant to the measurement. There were no transfers between levels for the three and six months ended June 30, 2014. At June 30, 2014, the Company had an interest rate swap and foreign exchange forward contracts recorded at fair value. The fair value of the interest rate swap is calculated using standard industry models based on observable forward yield curves. The fair value of the foreign exchange forward contracts is calculated using standard industry models based on observable forward points and discount curves. The fair values of all derivative instruments are adjusted for credit risk and restrictions and other terms specific to the contracts.

The Company estimates fair value of its financial instruments utilizing an established three-level hierarchy. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date as follows:

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

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The following table provides a summary by level of the fair value of financial instruments that are measured on a recurring basis:

(in millions)	June 30, 2014	Fair Value Measurements at June 30, 2014 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swap	$1.9	$—	$1.9	$—
Foreign exchange forward contracts	1.3	—	1.3	—
	$3.2	$—	$3.2	$—

(in millions)	December 31, 2013	Fair Value Measurements at December 31, 2013 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swap	$2.3	$—	$2.3	$—
	$2.3	$—	$2.3	$—

The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term maturity of those instruments. Borrowings under the 2012 Credit Agreement are at variable interest rates and accordingly their carrying amounts approximate fair value. The fair value of the Senior Notes was approximately $412.0 million at June 30, 2014. The fair value of the Sealy 8.0% Notes was approximately $102.1 million at June 30, 2014. The fair value of the Senior Notes and the 8.0% Sealy Notes were based on Level 2 inputs such as quoted market prices or estimated using discounted cash flows and market-based expectations for interest rates, credit risk, and the contractual terms of the debt instruments.

(9) Stockholders’ Equity

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

(10) Defined Benefit Plans

As of June 30, 2014, the Company's liability related to its defined benefit plan for U.S. Sealy employees was $6.6 million. As of June 30, 2014, the defined benefit plan for employees of Sealy Canada, Ltd. was overfunded and not material. The net periodic pension cost for the three and six months ended June 30, 2014 and 2013 were not material.

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(11) Other Items

Accumulated other comprehensive income.

Accumulated other comprehensive income consisted of the following:

(in millions)	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
Foreign Currency Translation								
Balance at beginning of period	$(14.8	)	$(16.0	)	$(15.6	)	$(4.9	)
Other comprehensive income (loss):								
Foreign currency translation adjustments (1)	3.4		(6.6	)	4.2		(17.7	)
Balance at end of period	$(11.4	)	$(22.6	)	$(11.4	)	$(22.6	)
Interest Rate Swap								
Balance at beginning of period	$(1.3	)	$(2.3	)	$(1.4	)	$(2.7	)
Other comprehensive income:								
Net change from period revaluations:	0.7		1.8		1.4		3.2	
Tax (expense)(2)	(0.3	)	(0.7	)	(0.6	)	(1.1	)
Total other comprehensive income before reclassifications, net of tax	$0.4		$1.1		$0.8		$2.1	
Net amount reclassified to earnings (3)	(0.5	)	(0.8	)	(1.0	)	(1.6	)
Tax benefit (2)	0.2		0.4		0.4		0.6	
Total amount reclassified from accumulated other comprehensive loss, net of tax	$(0.3	)	$(0.4	)	$(0.6	)	$(1.0	)
Total other comprehensive income	0.1		0.7		0.2		1.1	
Balance at end of period	$(1.2	)	$(1.6	)	$(1.2	)	$(1.6	)
Pension Benefits								
Balance at beginning of period	$3.2		$—		$3.2		$—	
Other comprehensive income:								
Net change from period revaluations:	0.5		—		0.5		—	
Tax (expense)(2)	(0.2	)	—		(0.2	)	—	
Total other comprehensive income before reclassifications, net of tax	$0.3		$—		$0.3		$—	
Net amount reclassified to earnings	—		—		—		—	
Tax benefit (2)	—		—		—		—	
Total amount reclassified from accumulated other comprehensive loss, net of tax	$—		$—		$—		$—	
Total other comprehensive income	0.3		—		0.3		—	
Balance at end of period	$3.5		$—		$3.5		$—	
Foreign Exchange Forward Contracts								
Balance at beginning of period	$0.9		$—		$—		$—	
Other comprehensive income:								
Net change from period revaluations:	(2.1	)	—		(0.4	)	—	

Tax (expense)(2)	0.5	—	0.1	—
Total other comprehensive income before reclassifications, net of tax	$(1.6)	$—	$(0.3)	$—
Net amount reclassified to earnings	(0.1)		(0.7)	
Tax benefit(2)	—	—	0.2	—
Total amount reclassified from accumulated other comprehensive income, net of tax	$(0.1)	$—	$(0.5)	$—
Total other comprehensive income	(1.7)	—	(0.8)	—
Balance at end of period	$(0.8)	$—	$(0.8)	$—

(1) In 2014 and 2013, there were no tax impacts related to rate changes and no amounts were reclassified to earnings.
(2) These amounts were included in the income tax provision on the accompanying Condensed Consolidated Statements of Operations.
(3) This amount was included in interest expense, net on the accompanying Condensed Consolidated Statements of Operations.

(12) Stock-Based Compensation

The Company’s stock-based compensation expense for the three and six months ended June 30, 2014 included performance-based restricted stock units (“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 below:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
PRSU (benefit) expense	$(0.9)	$1.2	$0.2	$2.0
Option expense	1.7	2.1	3.4	4.2
RSU/DSU expense	0.5	1.4	1.8	2.0
Total stock based compensation expense	$1.3	$4.7	$5.4	$8.2

Actual payout under the PRSUs granted in 2013 is dependent upon the achievement of certain financial goals. The Company recorded a $3.0 million benefit in the accompanying Condensed Consolidated Statements of Income for the three and six months ended June 30, 2014, after re-evaluation of the probability of meeting these grants.

A summary of the Company’s PRSU activity and related information for the six months ended June 30, 2014 is presented below:

(shares in millions)	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Awards outstanding at December 31, 2013	0.3	$39.04	
Granted	0.3	51.86	
Vested	0.0	37.05	
Forfeited	(0.3)	39.56	
Awards outstanding at June 30, 2014	0.3	$51.86	$16.7

The maximum number of shares to be awarded under the PRSUs granted during the three and six months ended June 30, 2014 will be 0.7 million. Approximately 0.3 million shares will vest, if earned at the end of the two-year performance period ending on December 31, 2015. Approximately 0.4 million shares will vest if earned at the end of the three-year performance period ending on December 31, 2016.

During the six months ended June 30, 2014, PRSUs with an aggregate intrinsic value of $1.4 million were issued from treasury stock following the satisfaction of certain financial metrics over the one year performance period. The PRSUs were issued from treasury stock at 100.0% of the target award, the maximum payout. During the six months ended June 30, 2013, PRSUs with an aggregate intrinsic value of $14.9 million were issued from treasury stock following the satisfaction of certain financial metrics over the performance period. The PRSUs were issued from treasury stock at 282.0% of the target award, out of a maximum payout of 300.0%.

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A summary of the Company’s stock option activity and related information for the six months ended June 30, 2014 is presented below:
(shares in millions)

	Number of Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options outstanding December 31, 2013	2.8	$21.73		
Granted	0.2	51.91		
Forfeited	0.0	50.55		
Exercised	(0.1)	19.56		
Options outstanding at June 30, 2014	2.9	$24.11	5.63	$91.9
Options exercisable at June 30, 2014	2.3	$19.17	4.87	$94.7

The aggregate intrinsic value of options exercised during the three months ended June 30, 2014 and 2013 was $3.0 million and $4.4 million, respectively. The aggregate intrinsic value of options exercised during the six months ended June 30, 2014 and 2013 was $5.7 million and $12.4 million, respectively.

A summary of the Company’s RSU and DSU activity and related information for the six months ended June 30, 2014 is presented below:
(shares in millions)

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Awards outstanding at December 31, 2013	0.2	$47.00	
Granted	0.0	52.87	
Vested	(0.1)	44.00	
Forfeited	0.0	46.62	
Awards outstanding at June 30, 2014	0.1	$49.41	$5.0

There were no RSUs granted during the six months ended June 30, 2014. DSUs were granted during the six months ended June 30, 2014, and will vest over one year.

The aggregate intrinsic value of RSUs issued from treasury stock during the three months ended June 30, 2014 and 2013 was $0.5 million and $5.9 million, respectively. The aggregate intrinsic value of RSUs issued from treasury stock during the six months ended June 30, 2014 and 2013 was $5.4 million and $6.4 million, respectively.

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

A summary of total unrecognized stock-based compensation expense based on current performance estimates related to the PRSUs, options, RSUs and DSUs granted during the six months ended June 30, 2014 is presented below:
($ in millions)

	June 30, 2014	Weighted Average Remaining Vesting Period (Years)
Unrecognized PRSU expense	$12.3	2.02
Unrecognized stock option expense	4.1	2.57
Unrecognized RSU/DSU expense	0.7	0.83
Total unrecognized stock-based compensation expense	$17.1	2.11

(13) Commitments and Contingencies

(a) Purchase Commitments. The Company will, from time to time, enter into limited purchase commitments for the purchase of certain raw materials and components. Amounts committed under these programs are not significant as of June 30, 2014 and December 31, 2013.

(b) Norfolk County Retirement System, Individually and on behalf of all others similarly situated, Plaintiff v. Tempur-Pedic International Inc., Mark A. Sarvary and Dale E. Williams; filed June 20, 2012

Arthur Benning, Jr., Individually and on behalf of all others similarly situated, Plaintiff v. Tempur-Pedic International Inc., Mark A. Sarvary and Dale E. Williams; filed June 25, 2012

On June 20 and 25, 2012, the above suits were filed against the Company and two named executive officers in the United States District Court for the Eastern District of Kentucky, purportedly on behalf of a proposed class of shareholders who purchased the Company’s stock between January 25, 2012 and June 5, 2012. The complaints assert claims under Sections 10(b) and 20(a) of the Exchange Act, alleging, among other things, false and misleading statements and concealment of material information concerning the Company’s competitive position, projected net sales, earnings per diluted share and related financial performance for the Company’s 2012 fiscal year. The plaintiffs seek damages, interest, costs, attorney’s fees, expert fees and unspecified equitable/injunctive relief. On November 2, 2012, the Court consolidated the two lawsuits and on March 6, 2013, plaintiffs filed a consolidated complaint. On March 31, 2014, the Court issued an Order granting the Company’s motion to dismiss the consolidated complaint. On May 23, 2014, the Judge’s memorandum of opinion and judgment dismissing the case were entered. On June 6, 2014, the plaintiffs filed a notice of appeal. The Company intends to vigorously defend against the claims. The outcome of these matters is uncertain, however, and although the Company does not currently expect to incur a loss with respect to these matters, the Company cannot currently predict the manner and timing of the resolution of the suits, an estimate of a range of losses or any minimum loss that could result in the event of an adverse verdict in these suits, or whether the Company’s applicable insurance policies will provide sufficient coverage for these claims. 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.

(c) Sealy Mattress Company of NJ, Inc., David Hertz, individually, as trustee of, respectively, the Allison Lindsay Hertz Trust, the Samuel Douglas Hertz Trust, the Sydney Lauren Hertz Trust, the U/A DTD 08/21/97 Andrew Michael Marcus Trust, the U/A DTD 08/21/97 Julia Robyn Marcus Trust, and the U/A DTD 08/21/97 James Daniel

Marcus Trust, and as executor of the Estate of Walter Hertz, Lisa Marcus, Rose Naiman, Michael Shoobs, and Diane Shoobs, individually and as custodian of the Robert S. Shoobs UTMA NJ v. Sealy Corporation, filed June 27, 2013.

With respect to the Sealy Acquisition, holders of approximately 3.1 million shares of Sealy common stock sent notices to Sealy purporting to exercise their appraisal rights in accordance with the Merger Agreement executed on September 26, 2012. In order to preserve these appraisal rights, any such former stockholder was required to commence an appraisal proceeding in the Delaware courts within 120 days after March 18, 2013. Sealy has expressly reserved its rights to contest that any or all of such notices were not delivered timely or otherwise not in the form required under Delaware law. On June 27, 2013, an appraisal proceeding was commenced in the Delaware Court of Chancery (the "Appraisal Action"). If the fair value of the Sealy common stock formerly held by the former Sealy stockholders seeking the appraisal is determined to be greater than the $2.20 per share paid pursuant to the Merger Agreement, Sealy would be required to pay such difference, plus interest at the statutory rate, which could impact the Company's financial condition and liquidity.

(d) Michael Dodson, 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.

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. This matter is at a very preliminary stage, and the outcome is uncertain. As a result, the Company is unable to reasonably estimate the possible loss or range of losses, if any, arising from this litigation, or whether the Company's applicable insurance policies will provide sufficient coverage for 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.

(e) Environmental. The Company is currently conducting an environmental cleanup at a formerly owned facility in South Brunswick, New Jersey pursuant to the New Jersey Industrial Site Recovery Act. Sealy and one of its subsidiaries are parties to an Administrative Consent Order issued by the New Jersey Department of Environmental Protection. Pursuant to that order, Sealy and its subsidiary agreed to conduct soil and groundwater remediation at the property. The Company does not believe that its manufacturing processes were the source of contamination. The Company sold the property in 1997. The Company retained primary responsibility for the required remediation. Previously, the Company removed and disposed of contaminated soil from the site with the New Jersey Department of Environmental Protection approval, and the Company has installed a groundwater remediation system on the site. During 2005, with the approval of the New Jersey Department of Environmental Protection, the Company removed and disposed of sediment in Oakeys Brook adjoining the site. The Company continues to monitor ground water at the site. During 2012, with the approval of the New Jersey Department of Environmental Protection, the Company commenced the removal and disposal of additional contaminated soil from the site. The Company has recorded a reserve as a component of other accrued expenses and other noncurrent liabilities in the accompanying Consolidated Balance Sheets as of June 30, 2014 for $2.6 million associated with this remediation project.

The Company has also undertaken a remediation of soil and groundwater contamination at an inactive facility located in Oakville, Connecticut. Although the Company is conducting the remediation voluntarily, it obtained Connecticut Department of Energy and Environmental Protection ("DEEP") approval of the remediation plan. In 2012, the Company submitted separate closure reports to the Connecticut DEEP for the lower portion of the site and the upper portion of the site. The Connecticut DEEP approved the Company's closure report for the upper portion of the site and also gave conditional approval to the Company's closure report for the lower portion of the site. The Company is continuing to work with the Connecticut DEEP and is performing additional testing to obtain closure for the lower portion of the site. The Company has recorded a liability of approximately $0.1 million associated with the completion of the closure of its remediation efforts at the site. The Company does not believe the contamination on this site is attributable to the

Company's operations.

The Company cannot predict the ultimate timing or costs of the South Brunswick and Oakville environmental matters. Based on facts currently known, the Company believes that the accruals recorded are adequate and does not believe the resolution of these matters will have a material effect on the financial position or future operations of the Company. However, in the event of an adverse decision by the agencies involved, or an unfavorable result in the New Jersey natural resources damages matter, these matters could have a material effect on the Company's financial position or results of operations.

In 1998, the Company sold an inactive facility located in Putnam, Connecticut. In 2012, the Company received a letter from the attorney for the current owner of that property claiming that the Company may have some responsibility for an environmental condition on the property. The Company continues to investigate this matter, but intends to vigorously defend the claim of the current owner against the Company.

(f) Income Tax Assessments. The Company has received income tax assessments from the Danish Tax Authority ("SKAT"). The Company believes it has meritorious defenses to the proposed adjustments and will oppose the assessments, as necessary, in the appropriate Danish venue. The Company believes the litigation process to reach a final resolution of this matter could potentially extend over the next five years. If the Company is not successful in defending its position that the Company owes no additional taxes, the Company could be required to pay a significant amount to SKAT, which could impair or reduce the Company's liquidity and profitability. For a description of these assessments and additional information with respect to these assessments and the various related legal proceedings, see Note 14, "Income Taxes".

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

(14) Income Taxes

The Company's effective tax rate for the three months ended June 30, 2014 and 2013 was 132.4% and 131.3%, respectively. The Company's effective tax rate for the six months ended June 30, 2014 and 2013 was 45.7% and 52.2%, respectively. The Company's income tax rate for the three and six months ended June 30, 2014 and 2013 differed from the U.S. federal statutory rate of 35.0% principally due to changes in the Company's uncertain tax positions, certain foreign income tax rate differentials, state and local income taxes, the production activities deduction, permanent differences on the goodwill write-off associated with the disposal of the component facilities, and certain other permanent differences.

At June 30, 2014, the tax basis of the Company's investment in its foreign subsidiaries exceeds the Company's book basis. Accordingly, no deferred taxes have been recorded related to this basis difference as it is not apparent that the difference will reverse in the foreseeable future.

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 certain of Tempur Sealy International's U.S. subsidiaries to a Danish subsidiary. The royalty is paid by the U.S. subsidiaries for the right to utilize certain intangible assets owned by the Danish subsidiary in the U.S. production processes. In its assessment, SKAT asserts that the amount of royalty rate paid by the U.S. subsidiaries 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 2008 income tax assessment was received in March 2014. The cumulative total tax assessment for all years is approximately $236.3 million including interest and penalties. The Company filed timely protests with the Danish National Tax Tribunal (the "Tribunal") challenging the tax assessments. The Tribunal formally agreed to place the Danish tax litigation on hold pending the outcome of a Bilateral Advance Pricing Agreement ("Bilateral APA") between the United States and SKAT. A Bilateral APA involves an agreement between the Internal Revenue Service ("IRS") and the taxpayer, as well as a negotiated agreement with one or more foreign competent authorities under applicable income tax treaties. During the third quarter of 2008, the Company filed the Bilateral APA with the IRS and SKAT. U.S. and Danish competent authorities have met to discuss the Company's Bilateral APA. SKAT and the IRS met several times since 2011, most recently in February 2013, to discuss the matter. At the conclusion of the February 2013 meeting the IRS and SKAT concluded that a mutually acceptable agreement on the matter could not be reached and, as a result, the Bilateral APA process was terminated. The matter is now before the Tribunal. The Tribunal is a branch of SKAT that is independent of the discussions and negotiations that have taken place to date. If the Tribunal does not rule to the satisfaction of one or both parties, the party seeking redress may choose to litigate the issue in the Danish court system. In 2013 the Company was notified by SKAT that SKAT granted the deferral of the requirement to post a cash deposit or other form of security for taxes that have been assessed for the period 2001 through 2007 to 2017. During the quarter ended June 30, 2014, the Company was granted a deferral of the requirement to post a cash deposit or other form of security for taxes that have been assessed for 2008 to 2018. The Company believes it has meritorious defenses to the proposed adjustments and will oppose the assessments before the Tribunal and in the Danish courts, as necessary. The impact of terminating the Bilateral APA program has been considered by the Company in its June 30, 2014 estimate of uncertain tax benefits.

The Company maintains an uncertain tax liability associated with this matter, the amount of which is based on a royalty methodology and royalty rates that the Company considers to be reflective of market transactions. It is reasonably possible the amount of unrecognized tax benefits may change in the next twelve months. An estimate of the amount of such change cannot be

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

made at this time. If the Company is not successful in defending its position before the Tribunal or in the Danish courts, the Company could be required to pay significant amounts to SKAT, which could impair or reduce its liquidity and profitability. In conjunction with this tax examination discussed below, during the year ended December 31, 2013 the Company received correspondence from SKAT requesting information regarding the royalty for the years 2008 through 2011. The correspondence indicated that SKAT would be evaluating the royalty paid for each of the years under examination. The Company has responded to SKAT's request for information. During the three months ended December 31, 2013 the Company and SKAT agreed that the examination of this issue for the years 2008 - 2011 would be placed on hold pending the outcome of the Tribunal process.

The aggregate amount of uncertain tax benefits for all matters as of June 30, 2014 and December 31, 2013 was $26.4 million and $26.1 million, respectively. The entire amount of unrecognized tax benefits would impact the effective rate if recognized. The Company had approximately $11.5 million and $11.0 of accrued interest and penalties at June 30, 2014 and December 31, 2013, respectively.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The 2012 U.S. IRS examination began in March 2014. The IRS is in the information gathering phase of this examination. With few exceptions, the Company is no longer subject to tax examinations by the IRS in the U.S. for periods prior to 2012, U.S. state and local municipalities for periods prior to 2006, and in non-U.S. jurisdictions for periods prior to 2001. As it relates to Sealy for years prior to the Sealy Acquisition, Sealy or one of its subsidiaries was required to file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Sealy's U.S. federal income tax returns and with few exceptions its foreign income tax returns are no longer subject to examination for years prior to 2004. Generally, Sealy's state and local jurisdiction income tax returns are no longer subject to examination for years prior to 2000.

Additionally, the Company is currently under examination by various tax authorities around the world. The Company anticipates it is reasonably possible an increase or decrease in the amount of unrecognized tax benefits could be made in the next twelve months as a result of the statute of limitations expiring and/or the examinations being concluded on these returns. However, the Company does not presently anticipate that any increase or decrease in unrecognized tax benefits will be material to the consolidated financial statements. Other than the changes discussed in the preceding paragraphs, there were no significant changes to the liability for unrecognized tax benefits during the six months ended June 30, 2014.

(15) Major Customers

The top five customers accounted for approximately 34.4% and 31.7% of the Company's net sales for the three months ended June 30, 2014 and 2013, respectively. The top five customers accounted for approximately 32.9% and 31.3% of the Company's net sales for the six months ended June 30, 2014 and 2013, respectively. Net sales from one customer (Mattress Firm Holding Corp.) represented more than 10.0% of net sales for the three months and six months ended June 30, 2014. The top five customers also accounted for approximately 31.5% and 31.9% of accounts receivable as of June 30, 2014 and 2013, respectively.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(16) Earnings Per Common Share

(in millions, except per common share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net (loss) income attributable to Tempur Sealy International, Inc.	$(2.2)	$(1.6)	$25.2	$10.9
Denominator:				
Denominator for basic earnings per common share-weighted average shares	60.8	60.4	60.8	60.2
Effect of dilutive securities:				
Employee stock-based compensation	—	—	1.1	1.3
Denominator for diluted earnings per common share-adjusted weighted average shares	60.8	60.4	61.9	61.5
Basic (loss) earnings per common share	$(0.04)	$(0.03)	$0.41	$0.18
Diluted (loss) earnings per common share	$(0.04)	$(0.03)	$0.41	$0.18

The Company did not exclude any shares issuable upon exercise of outstanding stock options for the three months ended June 30, 2014, and excluded 0.3 million and 0.4 million shares issuable upon exercise of outstanding stock options for the six months ended June 30, 2014 and 2013 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.

(17) Business Segment Information

The Company operates in three business segments: Tempur North America, Tempur International and Sealy. The Tempur North America segment consists of two U.S. manufacturing facilities and the Tempur North America distribution subsidiaries. The Tempur International segment consists of a manufacturing facility in Denmark, whose customers include all of the distribution subsidiaries and third party distributors outside of the Tempur North America and Sealy segments. The Sealy segment consists of company-owned and operated bedding and component manufacturing facilities located around the world, along with distribution subsidiaries, joint ventures, and licensees. The Company evaluates segment performance based on net sales and operating income. Certain corporate operating expenses included in the Tempur North America segment for the three months ended June 30, 2014 and 2013 were $17.6 million and $21.0 million, respectively. Certain corporate operating expenses included in the Tempur North America segment for the six months ended June 30, 2014 and 2013 were $35.3 million and $50.3 million, respectively. There were no material allocations of corporate operating expenses to the Tempur International or Sealy segments for the six months ended June 30, 2014 and 2013. The Company's Tempur North America, Tempur International and Sealy segment assets include investments in subsidiaries which are appropriately eliminated in the Company's accompanying Condensed Consolidated Financial Statements. The remaining inter-segment eliminations are comprised of intercompany accounts receivable. The effect of the elimination of the investments in subsidiaries is included in the inter-segment eliminations as shown below.

The following table summarizes total assets by segment:

(in millions)	June 30, 2014	December 31, 2013
Total assets:		
Tempur North America	$2,591.5	$2,110.7
Tempur International	408.0	477.7
Sealy	1,962.9	1,956.6
Inter-segment eliminations	(2,210.5)	(1,815.1)
	$2,751.9	$2,729.9

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The following table summarizes long-lived assets by segment:

(in millions)	June 30,	December 31,
Long-lived assets:	2014	2013
Tempur North America	$391.7	$393.1
Tempur International	67.2	68.7
Sealy	1,392.5	1,459.5
	$1,851.4	$1,921.3

The following table summarizes long-lived assets by geographic region:

(in millions)	June 30,	December 31,
	2014	2013
United States	$1,578.0	$1,647.0
Canada	50.4	52.1
Other International	223.0	222.2
	$1,851.4	$1,921.3
Total International	273.4	274.3

The following table summarizes net sales by geographic region:

(in millions)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
United States	$524.2	$474.1	$1,028.2	$727.4
Canada	53.7	56.1	102.4	71.1
Other International	137.1	130.4	286.3	252.2
	$715.0	$660.6	$1,416.9	$1,050.7
Total International	$190.8	$186.5	$388.7	$323.3

The following table summarizes segment information:

(in millions)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net sales to external customers:				
Tempur North America				
Bedding	$223.9	$199.5	$423.4	$404.1
Other products	13.4	16.0	26.9	37.3
	$237.3	$215.5	$450.3	$441.4
Tempur International				
Bedding	$81.5	$73.9	$176.7	$163.2
Other products	28.0	26.6	58.5	54.8
	$109.5	$100.5	$235.2	$218.0
Sealy				
Bedding	$352.0	$325.1	$693.3	$369.8
Other products	16.2	19.5	38.1	21.5
	$368.2	$344.6	$731.4	$391.3

	$715.0	$660.6	$1,416.9	$1,050.7

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Inter-segment sales:				
Tempur North America	$1.7	$—	$1.8	$0.1
Tempur International	0.1	0.1	0.2	0.2
Sealy	4.2	—	8.5	—
Intercompany eliminations	(6.0)	(0.1)	(10.5)	(0.3)
	$—	$—	$—	$—
Gross profit:				
Tempur North America	$94.2	$88.5	$180.0	$191.9
Tempur International	64.1	62.5	139.2	136.8
Sealy	110.0	103.9	218.6	114.6
	$268.3	$254.9	$537.8	$443.3
Operating income:				
Tempur North America	$8.3	$10.3	$19.4	$26.1
Tempur International	19.2	23.9	47.2	55.2
Sealy	22.8	9.8	46.1	7.2
	$50.3	$44.0	$112.7	$88.5
(Loss) income before income taxes:				
Tempur North America	$(12.5)	$(22.9)	$(20.7)	$(34.6)
Tempur International	18.8	22.5	46.2	52.7
Sealy	1.1	7.1	21.1	3.7
	$7.4	$6.7	$46.6	$21.8
Depreciation and amortization (including stock-based compensation amortization):				
Tempur North America	$5.7	$10.8	$14.1	$20.6
Tempur International	3.4	3.1	6.6	6.2
Sealy	12.3	11.0	24.8	12.8
	$21.4	$24.9	$45.5	$39.6
Intercompany royalties:				
Tempur North America	$1.4	$1.4	$2.9	$2.7
Tempur International	(1.4)	(1.4)	(2.9)	(2.7)
Sealy	—	—	—	—
	$—	$—	$—	$—
Capital expenditures:				
Tempur North America	$4.1	$7.0	$6.1	$10.9
Tempur International	2.8	3.0	4.5	4.7
Sealy	2.2	3.7	6.3	3.7
	$9.1	$13.7	$16.9	$19.3

(18) Guarantor/Non-Guarantor Financial Information

The Senior Notes 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 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 indenture governing the Senior Notes; (c) the subsidiary's guarantee of indebtedness under the 2012 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 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 financial information presents Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013, and the related Condensed Consolidated Statements of Operations and Comprehensive Income and Cash Flows for the three months ended June 30, 2014 and 2013, for Tempur Sealy International, Combined Guarantor Subsidiaries and Combined Non-Guarantor Subsidiaries.

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Statements of Operations and Comprehensive Income
Three Months Ended June 30, 2014
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$—	$536.2	$ 190.9	$(12.1)	$715.0
Cost of sales	—	357.7	101.1	(12.1)	446.7
Gross profit	—	178.5	89.8	—	268.3
Selling and marketing expenses	0.4	109.1	45.7	—	155.2
General, administrative and other expenses	1.5	49.4	18.6	—	69.5
Equity income in earnings of unconsolidated affiliates	—	—	(2.1)	—	(2.1)
Royalty income, net of royalty expense	—	(4.6)	—	—	(4.6)
Operating (loss) income	(1.9)	24.6	27.6	—	50.3
Other expense, net:					
Third party interest expense, net	6.6	15.7	0.7	—	23.0
Intercompany interest expense (income), net	8.2	(8.6)	0.4	—	—
Interest expense, net	14.8	7.1	1.1	—	23.0
Loss on disposal of business	—	20.4	—	—	20.4
Other (income) expense, net	—	(0.7)	0.2	—	(0.5)
Total other expense	14.8	26.8	1.3	—	42.9
Income from equity investees	8.5	20.4	—	(28.9)	—
(Loss) income before income taxes	(8.2)	18.2	26.3	(28.9)	7.4
Income tax benefit (provision)	5.8	(9.7)	(5.9)	—	(9.8)
Net (loss) income	(2.4)	8.5	20.4	(28.9)	(2.4)
Less: net (loss) income attributable to non-controlling interest	(0.2)	(0.2)	—	0.2	(0.2)
Net (loss) income attributable to Tempur Sealy International, Inc.	$(2.2)	$8.7	$ 20.4	$(29.1)	$(2.2)
Comprehensive income attributable to Tempur Sealy International, Inc.	$0.1	$10.8	$ 22.0	$(32.8)	$0.1

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Statements of Operations and Comprehensive Income
Three Months Ended June 30, 2013
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$—	$478.7	$ 186.7	$(4.8)	$660.6
Cost of sales	—	315.8	94.7	(4.8)	405.7
Gross profit	—	162.9	92.0	—	254.9
Selling and marketing expenses	0.7	100.1	39.0	—	139.8
General, administrative and other expenses	4.6	51.5	20.2	—	76.3
Equity income in earnings of unconsolidated affiliates	—	—	(1.1)	—	(1.1)
Royalty income, net of royalty expense	—	(4.1)	—	—	(4.1)
Operating (loss) income	(5.3)	15.4	33.9	—	44.0
Other expense, net:					
Third party interest expense, net	9.8	25.3	0.6	—	35.7
Intercompany interest expense (income), net	8.2	(8.5)	0.3	—	—
Interest expense, net	18.0	16.8	0.9	—	35.7
Other (income) expense, net	—	(0.6)	2.2	—	1.6
Total other expense	18.0	16.2	3.1	—	37.3
Income from equity investees	13.7	23.1	—	(36.8)	—
(Loss) income before income taxes	(9.6)	22.3	30.8	(36.8)	6.7
Income tax benefit (provision)	7.5	(8.6)	(7.7)	—	(8.8)
Net (loss) income	(2.1)	13.7	23.1	(36.8)	(2.1)
Less: net (loss) income attributable to non-controlling interest	(0.5)	(0.5)	—	0.5	(0.5)
Net (loss) income attributable to Tempur Sealy International, Inc.	$(1.6)	$14.2	$ 23.1	$(37.3)	$(1.6)
Comprehensive (loss) income attributable to Tempur Sealy International, Inc.	$(7.5)	$14.6	$ 16.8	$(31.4)	$(7.5)

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Statements of Income and Comprehensive Income
Six Months Ended June 30, 2014
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$—	$1,044.5	$ 388.8	$(16.4)	$1,416.9
Cost of sales	—	697.7	197.8	(16.4)	879.1
Gross profit	—	346.8	191.0	—	537.8
Selling and marketing expenses	0.9	204.5	92.8	—	298.2
General, administrative and other expenses	5.7	98.3	35.8	—	139.8
Equity income in earnings of unconsolidated affiliates	—	—	(3.8)	—	(3.8)
Royalty income, net of royalty expense	—	(9.1)	—	—	(9.1)
Operating (loss) income	(6.6)	53.1	66.2	—	112.7
Other expense, net:					
Third party interest expense, net	13.4	30.8	1.0	—	45.2
Intercompany interest expense (income), net	16.3	(17.3)	1.0	—	—
Interest expense, net	29.7	13.5	2.0	—	45.2
Loss on disposal of business	—	20.4	—	—	20.4
Other (income) expense, net	—	(0.9)	1.4	—	0.5
Total other expense	29.7	33.0	3.4	—	66.1
Income from equity investees	49.2	48.6	—	(97.8)	—
Income before income taxes	12.9	68.7	62.8	(97.8)	46.6
Income tax benefit (provision)	12.4	(19.5)	(14.2)	—	(21.3)
Net income	25.3	49.2	48.6	(97.8)	25.3
Less: net income attributable to non-controlling interest	0.1	0.1	—	(0.1)	0.1
Net income attributable to Tempur Sealy International, Inc.	$25.2	$49.1	$ 48.6	$(97.7)	$25.2
Comprehensive income attributable to Tempur Sealy International, Inc.	$29.1	$51.5	$ 50.2	$(101.7)	$29.1

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Statements of Income and Comprehensive Income
Six Months Ended June 30, 2013
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	$—	$738.7	$ 323.5	$(11.5)	$1,050.7
Cost of sales	—	466.5	152.4	(11.5)	607.4
Gross profit	—	272.2	171.1	—	443.3
Selling and marketing expenses	1.4	152.7	72.1	—	226.2
General, administrative and other expenses	8.2	92.0	34.8	—	135.0
Equity income in earnings of unconsolidated affiliates	—	—	(1.3)	—	(1.3)
Royalty income, net of royalty expense	—	(5.1)	—	—	(5.1)
Operating (loss) income	(9.6)	32.6	65.5	—	88.5
Other expense, net:					
Third party interest expense, net	14.1	48.7	0.8	—	63.6
Intercompany interest expense (income), net	16.6	(16.9)	0.3	—	—
Interest expense, net	30.7	31.8	1.1	—	63.6
Other (income) expense, net	—	(0.3)	3.4	—	3.1
Total other expense	30.7	31.5	4.5	—	66.7
Income from equity investees	38.5	46.2	—	(84.7)	—
(Loss) income before income taxes	(1.8)	47.3	61.0	(84.7)	21.8
Income tax benefit (provision)	12.2	(8.8)	(14.8)	—	(11.4)
Net income	10.4	38.5	46.2	(84.7)	10.4
Less: net (loss) income attributable to non-controlling interest	(0.5)	(0.5)	—	0.5	(0.5)
Net income attributable to Tempur Sealy International, Inc.	$10.9	$39.0	$ 46.2	$(85.2)	$10.9
Comprehensive (loss) income attributable to Tempur Sealy International, Inc.	$(5.7)	$39.7	$ 31.7	$(71.4)	$(5.7)

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Balance Sheets
June 30, 2014
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$0.1	$80.8	$ 40.6	$—	$121.5
Accounts receivable, net	—	232.3	143.9	—	376.2
Inventories	—	161.2	58.8	—	220.0
Income taxes receivable	133.0	—	—	(133.0)	—
Prepaid expenses and other current assets	0.7	23.7	30.5	—	54.9
Deferred income taxes	9.4	30.5	5.5	—	45.4
Total Current Assets	143.2	528.5	279.3	(133.0)	818.0
Property, plant and equipment, net	—	292.8	73.6	—	366.4
Goodwill	—	557.3	184.2	—	741.5
Other intangible assets, net	—	618.7	124.8	—	743.5
Deferred tax asset	—	—	11.0	—	11.0
Other non-current assets	7.0	45.2	19.3	—	71.5
Net investment in subsidiaries	1,756.5	—	—	(1,756.5)	—
Due from affiliates	63.4	2,008.5	0.6	(2,072.5)	—
Total Assets	$1,970.1	$4,051.0	$ 692.8	$(3,962.0)	$2,751.9
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Accounts payable	$—	$187.6	$ 47.6	$—	$235.2
Accrued expenses and other current liabilities	1.4	142.0	61.6	—	205.0
Deferred income taxes	—	—	0.9	—	0.9
Income taxes payable	—	146.5	3.8	(133.0)	17.3
Current portion of long-term debt	—	49.6	3.2	—	52.8
Total Current Liabilities	1.4	525.7	117.1	(133.0)	511.2
Long-term debt	375.0	1,348.2	—	—	1,723.2
Deferred income taxes	—	235.9	32.5	—	268.4
Other non-current liabilities	—	72.9	8.7	—	81.6
Due to affiliates	1,426.2	111.8	884.4	(2,422.4)	—
Total Liabilities	1,802.6	2,294.5	1,042.7	(2,555.4)	2,584.4
Redeemable non-controlling interest	11.6	11.6	—	(11.6)	11.6

Total Stockholders’ Equity	155.9	1,744.9	(349.9	)	(1,395.0	)	155.9
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders’ Equity	$1,970.1	$4,051.0	$ 692.8		$(3,962.0	)	$2,751.9

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Balance Sheets
December 31, 2013
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$—	$30.9	$ 50.1	$—	$81.0
Accounts receivable, net	—	192.6	156.6	—	349.2
Inventories	—	147.5	51.7	—	199.2
Income taxes receivable	118.4	—	—	(118.4)	—
Prepaid expenses and other current assets	—	26.3	27.4	—	53.7
Deferred income taxes	10.0	29.3	5.1	—	44.4
Total Current Assets	128.4	426.6	290.9	(118.4)	727.5
Property, plant and equipment, net	—	335.9	75.7	—	411.6
Goodwill	—	577.2	182.4	—	759.6
Other intangible assets, net	—	624.6	125.5	—	750.1
Deferred tax asset	—	—	10.9	—	10.9
Other non-current assets	7.6	47.0	15.6	—	70.2
Net investment in subsidiaries	756.0	—	—	(756.0)	—
Due from affiliates	1,299.9	2,306.5	0.9	(3,607.3)	—
Total Assets	$2,191.9	$4,317.8	$ 701.9	$(4,481.7)	$2,729.9
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Accounts payable	$—	$140.5	$ 50.7	$—	$191.2
Accrued expenses and other current liabilities	1.4	144.2	62.8	—	208.4
Deferred income taxes	—	—	0.8	—	0.8
Income taxes payable	—	115.2	4.7	(118.4)	1.5
Current portion of long-term debt	—	36.6	3.0	—	39.6
Total Current Liabilities	1.4	436.5	122.0	(118.4)	441.5
Long-term debt	375.0	1,421.9	—	—	1,796.9
Deferred income taxes	—	252.8	33.3	—	286.1
Other non-current liabilities	—	69.1	6.2	—	75.3
Due to affiliates	1,685.4	1,381.5	940.5	(4,007.4)	—
Total Liabilities	2,061.8	3,561.8	1,102.0	(4,125.8)	2,599.8
Redeemable non-controlling interest	11.5	11.5	—	(11.5)	11.5

Total Stockholders' Equity	118.6	744.5	(400.1)	(344.4)	118.6
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	$2,191.9	$4,317.8	$ 701.9	$(4,481.7)	$2,729.9

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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, 2014
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash (used in) provided by operating activities	$(32.6)	$53.9	$ 51.1	$—	$72.4
CASH FLOWS FROM INVESTING ACTIVITIES:					
Acquisition of businesses, net of cash acquired	—	(0.2)	0.2	—	—
Proceeds from disposition of business	—	46.3	—	—	46.3
Purchases of property, plant and equipment	—	(11.3)	(5.6)	—	(16.9)
Other	—	0.1	(2.2)	—	(2.1)
Net cash used in investing activities	—	34.9	(7.6)	—	27.3
CASH FLOWS FROM FINANCING ACTIVITIES:					
Proceeds from 2012 Credit Agreement	—	106.5	—	—	106.5
Repayments 2012 Credit Agreement	—	(169.1)	—	—	(169.1)
Proceeds from issuance of Senior Notes	—	—	—	—	—
Net activity in investment in and advances from (to) subsidiaries and affiliates	29.9	24.5	(54.4)		—
Proceeds from exercise of stock options	3.5	—	—	—	3.5
Excess tax benefit from stock based compensation	1.5	—	—	—	1.5
Treasury stock repurchased	(2.2)	—	—	—	(2.2)
Payment of deferred financing costs	—	—	—	—	—
Other	—	(0.8)	1.0	—	0.2
Net cash provided by (used in) financing activities	32.7	(38.9)	(53.4)	—	(59.6)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	—	—	0.4	—	0.4
Increase (decrease) in cash and cash equivalents	0.1	49.9	(9.5)	—	40.5
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	—	30.9	50.1	—	81.0
	$0.1	$80.8	$ 40.6	$—	$121.5

CASH AND CASH EQUIVALENTS,
END OF PERIOD

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

TEMPUR SEALY INTERNATIONAL, INC.
Supplemental Condensed Consolidated Statements of Cash Flows
Six Months Ended June 30, 2013
(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash (used in) provided by operating activities	$(35.8)	$(7.0)	$ 31.3	$—	$(11.5)
CASH FLOWS FROM INVESTING ACTIVITIES:					
Acquisition of businesses, net of cash acquired	—	(1,035.3)	(137.6)	—	(1,172.9)
Proceeds from disposition of business	—	—	—	—	—
Purchases of property, plant and equipment	—	(14.0)	(5.3)	—	(19.3)