

TEMPUR SEALY INTERNATIONAL, INC.
Form 10-Q
August 05, 2016

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

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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

For the transition period from
to

Commission file number 001-31922

TEMPUR SEALY INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware

33-1022198

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

1000 Tempur Way

Lexington, Kentucky 40511

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

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

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

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

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

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

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

The number of shares outstanding of the registrant's common stock as of August 1, 2016 was 58,413,481 shares.

Table of Contents

Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q, including the information incorporated by reference herein, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which includes information concerning one or more of our plans; objectives; goals; strategies; future events; future revenues or performance; our implementation of our key strategic priorities and anticipated resulting growth in our sales, earnings and cash flow in both the U.S. and internationally on our business segments; uncertainties arising from global events; general economic, financial and industry conditions, particularly in the retail sector, as well as consumer confidence and the availability of consumer financing; competition in our industry; consumer acceptance of our products; the ability to continuously improve and expand our product line, maintain efficient, timely and cost-effective production and delivery of products, and manage growth; the ability to expand brand awareness, distribution and new products; the efficiency and effectiveness of our advertising campaigns and other marketing programs; the ability to increase sales productivity within existing retail accounts and to further penetrate the retail channel, including the timing of opening or expanding within large retail accounts and the timing and success of product launches; the effects of consolidation of retailers on revenues and costs; the effects of strategic investments on our operations, including our efforts to expand our global market share; changing commodity costs; changes in product and channel mix and the impact on the Company's gross margin; initiatives to improve gross margin and operating margin; our capital structure and increased debt level, including our ability to meet financial obligations and continue to comply with the terms and financial ratio covenants of our credit facilities; changes in interest rates; changes in foreign tax rates and changes in tax laws generally, including the ability to utilize tax loss carry forwards; effects of changes in foreign exchange rates on our reported earnings; the outcome of pending tax audits or other tax, regulatory or litigation proceedings and similar issues; the effect of future legislative or regulatory changes; financial flexibility; our expected sources of cash flow; our expected level of capital expenditures for 2016 and changes in capital expenditures; expectations regarding the impact of costs from headcount reductions and international store closures; and our ability to effectively manage cash. Many of these statements appear, in particular, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in ITEM 2 of Part I of this Report. When used in this report, the words "estimates," "expects," "guidance," "anticipates," "proposed," "projects," "plans," "intends," "believes" and variations of such words or similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon our current expectations and various assumptions. There can be no assurance that we will realize our expectations or that our beliefs will prove correct.

There are a number of risks, uncertainties and other important factors, many of which are beyond the Company's control, that could cause our actual results to differ materially from those expressed as forward-looking statements in this report, including the risk factors discussed under the heading "Risk Factors" under ITEM 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2015 and the risks identified in ITEM 1A of this Report. There may be other factors that may cause our actual results to differ materially from the forward-looking statements.

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

When used in this Report, except as specifically noted otherwise, the term "Tempur Sealy International" refers to Tempur

Sealy International, Inc. only, and the terms "Company," "we," "our," "ours" and "us" refer to Tempur Sealy International, Inc. and its consolidated subsidiaries. When used in this Report, the term "Sealy" refers to Sealy Corporation and its historical subsidiaries.

TABLE OF CONTENTS

	Page
<u>Special Note Regarding Forward-Looking Statements</u>	<u>2</u>
 <u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. Financial Statements</u>	
<u>Condensed Consolidated Statements of Income</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>6</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>7</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>8</u>
 <u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	 <u>32</u>
 <u>ITEM 3. Quantitative and Qualitative Disclosures About Market Risk</u>	 <u>50</u>
 <u>ITEM 4. Controls and Procedures</u>	 <u>51</u>
 <u>PART II. OTHER INFORMATION</u>	
 <u>ITEM 1. Legal Proceedings</u>	 <u>51</u>
 <u>ITEM 1A. Risk Factors</u>	 <u>51</u>
 <u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	 <u>51</u>
 <u>ITEM 3. Defaults upon Senior Securities</u>	 <u>52</u>
 <u>ITEM 4. Mine Safety Disclosures</u>	 <u>52</u>
 <u>ITEM 5. Other Information</u>	 <u>52</u>
 <u>ITEM 6. Exhibits</u>	 <u>53</u>
 <u>Signatures</u>	 <u>54</u>

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

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

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
Net sales	\$804.4	\$764.4	\$1,525.4	\$1,503.9
Cost of sales	467.5	466.9	897.5	927.7
Gross profit	336.9	297.5	627.9	576.2
Selling and marketing expenses	172.8	168.6	322.9	322.4
General, administrative and other expenses	71.9	85.1	143.6	162.8
Equity income in earnings of unconsolidated affiliates	(3.4)	(3.4)	(6.2)	(6.4)
Royalty income, net of royalty expense	(4.6)	(4.8)	(9.3)	(9.0)
Operating income	100.2	52.0	176.9	106.4
Other expense, net:				
Interest expense, net	23.1	20.5	44.5	40.9
Loss on extinguishment of debt	47.2	—	47.2	—
Other expense (income), net	0.7	2.2	(0.3)	0.9
Total other expense, net	71.0	22.7	91.4	41.8
Income before income taxes	29.2	29.3	85.5	64.6
Income tax provision	(9.2)	(8.3)	(26.5)	(18.6)
Net income before non-controlling interest	20.0	21.0	59.0	46.0
Less: Net (loss) income attributable to non-controlling interest ^{(1),(2)}	(1.3)	(0.2)	(1.9)	1.4
Net income attributable to Tempur Sealy International, Inc.	\$21.3	\$21.2	\$60.9	\$44.6
Earnings per common share:				
Basic	\$0.35	\$0.35	\$1.00	\$0.73
Diluted	\$0.35	\$0.34	\$0.99	\$0.72
Weighted average common shares outstanding:				
Basic	60.2	61.3	61.1	61.1
Diluted	60.8	62.4	61.7	62.3

(Loss) attributable to the Company's redeemable non-controlling interest in Comfort Revolution, LLC for the three months ended June 30, 2016 and 2015 represented \$(1.3) million and \$(0.1) million, respectively. (Loss) income attributable to the Company's redeemable non-controlling interest in Comfort Revolution, LLC for the six months ended June 30, 2016 and 2015 represented \$(1.9) million and \$0.5 million, respectively.

(2) As of June 30, 2015, the redemption value exceeded the accumulated earnings of the Company's redeemable non-controlling interest in Comfort Revolution, LLC. Accordingly, for the three and six months ended June 30, 2015, the Company recorded a \$(0.1) million and \$0.9 million adjustment, net of tax, respectively, to adjust the carrying value of redeemable non-controlling interest to its redemption value. As of June 30, 2016, the

accumulated earnings exceeded the redemption value and, accordingly, a redemption value adjustment was not necessary for the three or six months ended June 30, 2016.

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ in millions)

(unaudited)

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
Net income before non-controlling interest	\$20.0	\$21.0	\$59.0	\$46.0
Other comprehensive (loss) income before tax, net of tax				
Foreign currency translation adjustments	(2.3)	7.2	16.8	(30.4)
Net change in unrecognized gain on interest rate swap, net of tax	—	0.2	—	0.3
Pension expense, net of tax	—	(0.1)	—	(0.1)
Unrealized (loss) gain on cash flow hedging derivatives, net of tax	(1.0)	(0.1)	(5.9)	1.2
Other comprehensive (loss) income, net of tax	(3.3)	7.2	10.9	(29.0)
Comprehensive income	16.7	28.2	69.9	17.0
Less: Comprehensive (loss) income attributable to non-controlling interest ^{(1),(2)}	(1.3)	(0.2)	(1.9)	1.4
Comprehensive income attributable to Tempur Sealy International, Inc.	\$18.0	\$28.4	\$71.8	\$15.6

(Loss) attributable to the Company's redeemable non-controlling interest in Comfort Revolution, LLC for the three months ended June 30, 2016 and 2015 represented \$(1.3) million and \$(0.1) million, respectively. (Loss) income attributable to the Company's redeemable non-controlling interest in Comfort Revolution, LLC for the six months ended June 30, 2016 and 2015 represented \$(1.9) million and \$0.5 million, respectively.

As of June 30, 2015, the redemption value exceeded the accumulated earnings of the Company's redeemable non-controlling interest in Comfort Revolution, LLC. Accordingly, for the three and six months ended June 30, 2015, the Company recorded a \$(0.1) million and \$0.9 million adjustment, net of tax, respectively, to adjust the carrying value of redeemable non-controlling interest to its redemption value. As of June 30, 2016, the accumulated earnings exceeded the redemption value and, accordingly, a redemption value adjustment was not necessary for the three or six months ended June 30, 2016.

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(\$ in millions)

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 137.9	\$ 153.9
Accounts receivable, net	414.0	379.4
Inventories, net	225.6	199.2
Prepaid expenses and other current assets	71.4	76.6
Total Current Assets	848.9	809.1
Property, plant and equipment, net	362.2	361.7
Goodwill	719.6	709.4
Other intangible assets, net	691.9	695.4
Deferred income taxes	12.5	12.2
Other non-current assets	84.3	67.7
Total Assets	\$ 2,719.4	\$ 2,655.5
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 253.5	\$ 266.3
Accrued expenses and other current liabilities	263.7	254.0
Income taxes payable	1.1	11.2
Current portion of long-term debt	150.2	181.5
Total Current Liabilities	668.5	713.0
Long-term debt, net	1,526.6	1,273.3
Deferred income taxes	194.6	195.4
Other non-current liabilities	161.7	171.2
Total Liabilities	2,551.4	2,352.9
Commitments and contingencies—see Note 8		
Redeemable non-controlling interest	10.5	12.4
Total Stockholders' Equity	157.5	290.2
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	\$ 2,719.4	\$ 2,655.5

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ in millions)

(unaudited)

	Six Months Ended June 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income before non-controlling interest	\$59.0	\$46.0
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	36.0	36.6
Amortization of stock-based compensation	10.6	11.7
Amortization of deferred financing costs	2.5	4.5
Bad debt expense	1.8	3.0
Deferred income taxes	(0.9)	(14.7)
Dividends received from unconsolidated affiliates	3.6	1.9
Equity income in earnings of unconsolidated affiliates	(6.2)	(6.4)
Non-cash interest expense on convertible notes	3.6	2.6
Loss on extinguishment of debt	47.2	—
Loss on sale of assets	0.5	0.8
Foreign currency adjustments and other	(1.2)	2.4
Changes in operating assets and liabilities	(104.6)	(87.3)
Net cash provided by operating activities	51.9	1.1
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(24.3)	(34.0)
Proceeds from disposition of business and other	—	7.1
Net cash used in investing activities	(24.3)	(26.9)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings under long-term debt obligations	1,435.3	283.0
Repayments of borrowings under long-term debt obligations	(1,230.4)	(311.5)
Proceeds from exercise of stock options	6.0	10.5
Excess tax benefit from stock-based compensation	3.0	14.7
Treasury stock repurchased	(217.3)	(1.2)
Payments of deferred financing costs	(6.2)	—
Fees paid to lenders	(7.8)	—
Call premium on 2020 Senior Notes	(23.6)	—
Other	0.4	(1.2)
Net cash used in financing activities	(40.6)	(5.7)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(3.0)	4.4
Decrease in cash and cash equivalents	(16.0)	(27.1)
CASH AND CASH EQUIVALENTS, beginning of period	153.9	62.5
CASH AND CASH EQUIVALENTS, end of period	\$137.9	\$35.4

Supplemental cash flow information:

Cash paid during the period for:

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Interest	\$36.5	\$33.1
Income taxes, net of refunds	40.4	58.2

See accompanying Notes to Condensed Consolidated Financial Statements.

7

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited)

(1) Summary of Significant Accounting Policies

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

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

The Company's Condensed Consolidated Financial Statements include the results of Comfort Revolution, LLC ("Comfort Revolution"), a 45.0% owned joint venture. Comfort Revolution constitutes a variable interest entity ("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. The operations of Comfort Revolution are not material to the Company's Condensed Consolidated Financial Statements.

The Company also has ownership interests in a group of Asia-Pacific joint ventures to develop markets for Sealy® branded products in those regions. The Company's ownership interest in these joint ventures is 50.0%. The equity method of accounting is used for these joint ventures, over which the Company has significant influence but does not have control, and consolidation is not otherwise required. The Company's carrying value in its equity method investments of \$15.9 million and \$13.6 million at June 30, 2016 and December 31, 2015, respectively, are recorded in other non-current assets within the accompanying Condensed Consolidated Balance Sheets. The Company's share of earnings is recorded as equity income in earnings of unconsolidated affiliates in the accompanying Condensed Consolidated Statements of Income.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States ("U.S. GAAP" or "GAAP") for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Company and related footnotes for the year ended December 31, 2015, included in the Company's Annual Report on Form 10-K filed on February 12, 2016.

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

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

	June	December
	30,	31,
(in millions)	2016	2015
Finished goods	\$ 150.5	\$ 126.7
Work-in-process	13.3	14.0

Raw materials and supplies	61.8	58.5
	\$225.6	\$ 199.2

(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.

8

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The Company had the following activity for sales returns from December 31, 2015 to June 30, 2016:
(in millions)

Balance as of December 31, 2015	\$28.5
Amounts accrued	67.5
Returns charged to accrual	(64.6)
Balance as of June 30, 2016	\$31.4

(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. In estimating its warranty obligations, the Company considers the impact of recoverable salvage value on warranty costs in determining its estimate of future warranty obligations.

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

The Company had the following activity for its accrued warranty expense from December 31, 2015 to June 30, 2016:
(in millions)

Balance as of December 31, 2015	\$29.6
Amounts accrued	21.5
Warranties charged to accrual	(16.8)
Balance as of June 30, 2016	\$34.3

As of June 30, 2016 and December 31, 2015, \$19.0 million and \$14.9 million of accrued warranty expense is included as a component of accrued expenses and other current liabilities and \$15.3 million and \$14.7 million of accrued warranty expense is included in other non-current liabilities on the Company's accompanying Condensed Consolidated Balance Sheets, respectively.

(e) Revenue Recognition. Sales of products are recognized when persuasive evidence of an arrangement exists, title passes to customers and the risks and rewards of ownership are transferred, the sales price is fixed or determinable and collectability is reasonably assured. The Company extends volume discounts to certain customers, as well as promotional allowances, floor sample discounts, commissions paid to retail associates and slotting fees, and reflects these amounts as a reduction of sales at the time revenue is recognized based on historical experience. The Company also reports sales net of tax assessed by qualifying governmental authorities. The Company extends credit based on the creditworthiness of its customers. No collateral is required on sales made in the normal course of business.

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's accounts receivable. The Company regularly reviews the adequacy of its allowance for doubtful accounts. The Company determines the allowance based on historical write-off experience and current economic conditions and also considers factors such as customer credit, past transaction history with the customer and changes in customer payment terms when determining whether the collection of a customer receivable is reasonably assured. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the

potential for recovery is considered remote. The allowance for doubtful accounts included in accounts receivable, net in the accompanying Condensed Consolidated Balance Sheets was \$24.8 million and \$23.3 million as of June 30, 2016 and December 31, 2015, respectively.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(f) Cooperative Advertising, Rebate and Other Promotional Programs. The Company enters into agreements with customers to provide funds for advertising and promotions. The Company also enters into volume and other rebate programs with customers. When sales are made to these customers, the Company records liabilities pursuant to these agreements. The Company periodically assesses these liabilities based on actual sales and claims to determine whether all of the cooperative advertising earned will be used by the customer or whether the customer will meet the requirements to receive rebate funds. The Company generally negotiates these agreements on a customer-by-customer basis. Some of these agreements extend over several years. Significant estimates are required at any point in time with regard to the ultimate reimbursement to be claimed by the customers. Subsequent revisions to these estimates are recorded and charged to earnings in the period in which they are identified. Rebates and cooperative advertising are classified as a reduction of revenue and presented within net sales on the accompanying Condensed Consolidated Statements of Income. Certain cooperative advertising expenses are reported as components of selling and marketing expenses in the accompanying Condensed Consolidated Statements of Income because the Company receives an identifiable benefit and the fair value of the advertising benefit can be reasonably estimated.

(g) Derivative Financial Instruments. Derivative financial instruments are used in the normal course of business to manage interest rate and foreign currency exchange risks. The financial instruments used by the Company are straight-forward, non-leveraged instruments. The counterparties to these financial instruments are financial institutions with strong credit ratings. The Company maintains control over the size of positions entered into with any one counterparty and regularly monitors the credit ratings of these institutions. For all transactions designated as hedges, the hedging relationships are formally documented at the inception and on an ongoing basis in offsetting changes in cash flows of the hedged transaction.

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

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

The Company manages a portion of the risk associated with fluctuations in foreign currencies related to intercompany and third party inventory purchases denominated in foreign currencies through foreign exchange forward contracts designated as cash flow hedges. As of June 30, 2016, the Company had foreign exchange forward contracts designated as cash flow hedges to buy U.S. dollars and to sell Canadian dollars with a notional amount outstanding of \$63.8 million. These foreign exchange forward contracts have maturities ranging from July 2016 to September 2017. The effectiveness of the cash flow hedge contracts, including time value, is assessed prospectively and retrospectively on a monthly basis using regression analysis, as well as using other timing and probability criteria. 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 OCL until the underlying hedged item is reflected in the Company's accompanying Condensed Consolidated Statements of Income, at which time the effective amount in AOCL is reclassified to cost of sales in the accompanying Condensed Consolidated Statements of Income. The

Company expects to reclassify a gain of approximately \$0.8 million, net of tax over the next 12 months based on June 30, 2016 exchange rates.

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

(h) Income Taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are also recognized for the estimated future effects of tax loss carry forwards. The effect of changes in tax rates on deferred taxes is recognized in the period in which any such

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

change is enacted. Valuation allowances are established when necessary on a jurisdictional basis to reduce deferred tax assets to the amounts expected to be realized. The Company accounts for uncertain foreign and domestic tax positions utilizing a proscribed recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

(i) Pensions. In the period ended June 30, 2016, the Company contributed \$10.0 million to its U.S. defined benefit pension plan.

(2) Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (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. This ASU is based on the core principle that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. 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, 2017, including interim periods within that reporting period. The Company is currently evaluating this ASU to determine the Company's adoption method and the impact it will have on the Company's Condensed Consolidated Financial Statements.

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

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and the classification on the statement of cash flows. When adopting this ASU, entities should use a modified retrospective approach when adopting amendments related to the timing of excess tax benefit recognition, minimum statutory withholding requirements and forfeitures, and a retrospective approach when adopting amendments related to recognition of excess tax benefits and tax deficiencies in the income statement; and entities have the option of using a prospective or a retrospective transition approach when adopting amendments related to the presentation of excess tax benefits on the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating this ASU to determine the Company's adoption method and the impact it will have on the Company's Condensed Consolidated Financial Statements.

(3) Goodwill

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

(in millions)	North America	International	Consolidated
Balance as of December 31, 2015	\$ 562.8	\$ 146.6	\$ 709.4
Foreign currency translation adjustments	4.3	5.9	10.2
Balance as of June 30, 2016	\$ 567.1	\$ 152.5	\$ 719.6

11

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(4) Debt

Debt for the Company consists of the following:

(in millions, except percentages)	June 30, 2016		December 31, 2015		Maturity Date
	Amount	Rate	Amount	Rate	
Debt:					
2016 Credit Agreement					
Term A Facility	\$500.0	(1)	\$—	N/A	April 6, 2021
2012 Credit Agreement					
Term A Facility	—	N/A	409.4	(2)	March 18, 2018
Term B Facility	—	N/A	100.1	(3)	March 18, 2020
2026 Senior Notes	600.0	5.500%	—	N/A	June 15, 2026
2023 Senior Notes	450.0	5.625%	450.0	5.625%	October 15, 2023
2020 Senior Notes	—	N/A	375.0	6.875%	December 15, 2020
8.0% Sealy Notes	114.7	8.0%	111.1	8.0%	July 15, 2016
Capital lease obligations and other	23.4		34.0		Various
Total debt	1,688.1		1,479.6		
Less: deferred financing costs	(11.3)		(24.8)		
Total debt, net	1,676.8		1,454.8		
Less: current portion	(150.2)		(181.5)		
Total long-term debt, net	\$1,526.6		\$1,273.3		

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

(2) Interest at LIBOR plus applicable margin of 2.00% as of December 31, 2015.

(3) Interest at LIBOR, subject to a 0.75% floor plus applicable margin of 2.75% as of December 31, 2015.

The Company is in compliance with all applicable covenants as of June 30, 2016.

2016 Credit Agreement

On April 6, 2016, the Company entered into a senior secured credit agreement ("2016 Credit Agreement") with a syndicate of banks. The 2016 Credit Agreement replaced the Company's 2012 Credit Agreement. The 2016 Credit Agreement provides for a \$500.0 million revolving credit facility, a \$500.0 million initial term loan facility and a \$100.0 million delayed draw term loan facility. At any time, the Company may also elect to request the establishment of one or more incremental term loan facilities and/or increase commitments under the revolving credit facility in an aggregate amount of up to \$500.0 million. A portion of the revolving credit facility of up to \$250.0 million is available in Canadian Dollars, Pounds Sterling, the Euro and any additional currencies determined by mutual agreement of the Company, the Agent and the lenders under the revolving credit facility. A portion of the revolving credit facility of up to \$100.0 million is available for the issuance of letters of credit for the account of the Company and a portion of the revolving credit facility of up to \$50.0 million is available for swing line loans to the Company.

Borrowings under the 2016 Credit Agreement will generally bear interest, at the election of Tempur Sealy International and the other subsidiary borrowers, at either (i) LIBOR plus the applicable margin or (ii) Base Rate plus the applicable margin. For the revolving credit facility and the initial term loan facility (a) the initial applicable margin for LIBOR advances was 1.75% per annum and the initial applicable margin for Base Rate advances was 0.75% per annum, and (b) thereafter following the delivery of consolidated financial statements for the fiscal quarter ending March 31, 2016, such applicable margins are determined by a pricing grid based on the consolidated total net leverage

ratio of the Company. Once drawn, the delayed draw term loan facility will have identical pricing to the revolving credit facility and initial term loan facility.

Obligations under the 2016 Credit Agreement are guaranteed by the Company's existing and future direct and indirect wholly-owned domestic subsidiaries, subject to certain exceptions. The 2016 Credit Agreement is secured by a security interest in substantially all of Tempur Sealy International's and the other subsidiary borrowers' domestic assets and the domestic assets of each subsidiary guarantor, whether owned as of the closing or thereafter acquired, including a pledge of 100.0% of the equity

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

interests of each subsidiary guarantor that is a domestic entity (subject to certain limited exceptions) and 65.0% of the voting equity interests of any direct first tier foreign entity owned by a subsidiary guarantor. The 2016 Credit Agreement requires compliance with certain financial covenants providing for maintenance of a minimum consolidated interest coverage ratio, maintenance of a maximum consolidated total net leverage ratio, and maintenance of a maximum consolidated secured net leverage ratio. The consolidated total net leverage ratio is calculated using consolidated funded debt less qualified cash. Consolidated funded debt includes debt recorded on the Condensed Consolidated Balance Sheets as of the reporting date, plus letters of credit outstanding and short-term other debt. The Company is allowed to subtract from consolidated funded debt an amount equal to 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, 2016, domestic qualified cash was \$61.9 million and foreign qualified cash was \$45.6 million.

The 2016 Credit Agreement contains certain customary negative covenants, which include limitations on liens, investments, indebtedness, dispositions, mergers and acquisitions, the making of restricted payments, changes in the nature of business, changes in fiscal year, transactions with affiliates, use of proceeds, prepayments of certain indebtedness, entry into burdensome agreements and changes to governing documents and other junior financing documents. The 2016 Credit Agreement also contains certain customary affirmative covenants and events of default, including upon a change of control.

The Company is required to pay a commitment fee on the unused portion of the revolving credit facility, which initially was 0.30% per annum and thereafter following the delivery of consolidated financial statements for the fiscal quarter ending March 31, 2016, such fees are determined by a pricing grid based on the consolidated total net leverage ratio of the Company. This unused commitment fee is payable quarterly in arrears and on the date of termination or expiration of the commitments under the revolving credit facility. The Company and the other borrowers also pay customary letter of credit issuance and other fees under the 2016 Credit Agreement.

As a result of the Company's 2016 Credit Agreement, \$3.6 million of deferred financing costs were capitalized in the second quarter of 2016 and will be amortized as interest expense over the respective debt instrument period, 5 years, using the effective interest method. In addition, the Company expensed \$1.9 million of lender fees associated with this transaction in the second quarter of 2016, which is included in loss on extinguishment of debt in the Condensed Consolidated Statement of Income.

2012 Credit Agreement

The Company used the proceeds from the 2016 Credit Agreement to repay in full and terminate the 2012 Credit Agreement. 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").

In conjunction with the repayment of all outstanding borrowings on the 2012 Credit Agreement, the Company wrote off approximately \$11.0 million of deferred financing costs in the second quarter of 2016, which is included in loss on extinguishment of debt in the Condensed Consolidated Statement of Income.

Senior Notes

2026 Senior Notes

On May 24, 2016, Tempur Sealy International issued \$600.0 million aggregate principal amount of 5.500% senior notes due 2026 (the "2026 Senior Notes") in a private offering 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 2026 Senior Notes were issued pursuant to an indenture, dated as of May 24, 2016 (the "2026 Indenture"), among Tempur Sealy International, certain subsidiaries of Tempur Sealy International as guarantors (the "Combined Guarantor Subsidiaries"), and The Bank of New York Mellon Trust Company, N.A., as trustee. The 2026 Senior Notes are general unsecured senior obligations of Tempur Sealy International and are guaranteed on a senior unsecured basis by the Combined Guarantor Subsidiaries. The 2026 Senior Notes mature on June 15, 2026, and interest is payable semi-annually in arrears on each June 15 and December 15, beginning on December 15, 2016. The gross proceeds from the 2026 Senior Notes were used to refinance the \$375.0 million aggregate principal amount of 6.875% senior notes due 2020 (the "2020 Senior Notes") and to pay related fees and expenses, and the remaining funds will be used for general corporate purposes.

Tempur Sealy International has the option to redeem all or a portion of the 2026 Senior Notes at any time on or after June 15, 2021. The initial redemption price is 102.750% of the principal amount, plus accrued and unpaid interest, if any. The redemption

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

price will decline each year after 2021 until it becomes 100.0% of the principal amount beginning on June 15, 2024. In addition, Tempur Sealy International has the option at any time prior to June 15, 2021 to redeem some or all of the 2026 Senior Notes at 100.0% of the original principal amount plus a “make-whole” premium and accrued and unpaid interest, if any. Tempur Sealy International may also redeem up to 35.0% of the 2026 Senior Notes prior to June 15, 2019, under certain circumstances with the net cash proceeds from certain equity offerings, at 105.500% of the principal amount plus accrued and unpaid interest, if any. Tempur Sealy International may make such redemptions as described in the preceding sentence only if, after any such redemption, at least 65.0% of the original aggregate principal amount of the 2026 Senior Notes issued remains outstanding.

The 2026 Indenture restricts the ability of Tempur Sealy International and the ability of certain of its subsidiaries to, among other things: (i) incur, directly or indirectly, debt; (ii) make, directly or indirectly, certain investments and restricted payments; (iii) incur or suffer to exist, directly or indirectly, liens on its properties or assets; (iv) sell or otherwise dispose of, directly or indirectly, assets; (v) create or otherwise cause or suffer to exist any consensual restriction on the right of certain of the subsidiaries of Tempur Sealy International to pay dividends or make any other distributions on or in respect of their capital stock; (vi) enter into transactions with affiliates; (vii) engage in sale-leaseback transactions; (viii) purchase or redeem capital stock or subordinated indebtedness; (ix) issue or sell stock of restricted subsidiaries; and (x) effect a consolidation or merger. These covenants are subject to a number of exceptions and qualifications.

In conjunction with the issuance and sale of the 2026 Senior Notes, Tempur Sealy International and the Combined Guarantor Subsidiaries agreed through a Registration Rights Agreement to exchange the 2026 Senior Notes for a new issue of substantially identical senior notes registered under the Securities Act. Tempur Sealy International and the Combined Guarantor Subsidiaries are required to pay additional interest if the 2026 Senior Notes are not registered within the time periods specified within the Registration Rights Agreement.

As a result of the issuance of the 2026 Senior Notes, \$3.1 million of deferred financing costs were capitalized in the second quarter of 2016 and will be amortized as interest expense over the respective debt instrument period, 10 years, using the effective interest method. In addition, the Company expensed \$5.9 million of lender fees associated with this transaction in the second quarter of 2016, which is included in loss on extinguishment of debt in the Condensed Consolidated Statement of Income.

2020 Senior Notes

The Company used the proceeds from the 2026 Senior Notes to refinance the 2020 Senior Notes and to pay related fees and expenses. The 2020 Notes were redeemed at a price equal to the principal amount thereof and the applicable “make-whole” premium, \$23.6 million, which is included in loss on extinguishment of debt in the Condensed Consolidated Statement of Income. In conjunction with the repayment of all outstanding borrowings on the 2012 Credit Agreement, the Company wrote off approximately \$4.8 million of deferred financing costs in the second quarter of 2016, which is included in loss on extinguishment of debt in the Condensed Consolidated Statement of Income.

Repayment of 8.0% Sealy Notes

In July 2016, the Company paid a total of approximately \$115.0 million in cash to holders of the 8.0% Senior Secured Third Lien Convertible Notes issued by Sealy Corporation and Sealy Mattress Company (the “8.0% Sealy Notes”) who properly converted their Sealy Notes in advance of the maturity date, pursuant to the terms of the 8.0% Sealy Notes.

In connection with the making of conversion payments with respect to, and the repayment of, the 8% Sealy Notes, on July 14, 2016, the Company also borrowed \$100.0 million using the delayed draw term loan facility under the Company's 2016 Credit Agreement. The commitment to provide the delayed draw term loan facility terminated with its funding.

(5) Fair Value Measurements

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 classification of fair value measurements within the established three-level hierarchy is based upon the lowest level of input that is significant to the measurements. There were no transfers between levels for the six months ended June 30, 2016

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

or year ended December 31, 2015. The fair value of our financial instruments which are recorded on a recurring basis at fair value are not material.

Financial instruments, although not recorded at fair value on a recurring basis, include cash and cash equivalents, accounts receivable, accounts payable, and the Company's debt obligations. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term maturity of those instruments. Borrowings under the 2012 Credit Agreement and 2016 Credit Agreement are at variable interest rates and accordingly their carrying amounts approximate fair value. The fair values of the following material financial instruments were based on Level 2 inputs estimated using discounted cash flows and market-based expectations for interest rates, credit risk, and the contractual terms of the debt instruments. The fair values of material financial instruments are as follows:

	Fair Value
(in millions)	June 30, 2016
	December 31, 2015
2020 Senior Notes	\$ 393.8
2023 Senior Notes	464.5
2026 Senior Notes	588.8
8.0% Sealy Notes	115.2

(6) Stockholder's Equity

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

(b) Treasury Stock. On February 1, 2016, the Board authorized a new share repurchase authorization of up to \$200.0 million of Tempur Sealy International's common stock. On June 7, 2016, the Board increased the authorization under the Company's share repurchase program by an additional \$200.0 million. As of June 30, 2016 the Company repurchased 3.8 million shares for approximately \$222.0 million under the share repurchase authorization. In the normal course of business, share repurchase transactions settle three days after the transaction date. As of June 30, 2016, approximately \$6.7 million of cash related to the share repurchases was in transit.

On July 25, 2016, the Board increased the authorization under the Company's share repurchase program by an additional \$200.0 million. From July 1, 2016 through July 27, 2016, the Company repurchased approximately 0.6 million shares for approximately \$34.2 million. As of July 27, 2016, the Company had approximately \$343.8 million remaining under the existing share repurchase authorization.

In addition, the Company acquired 0.1 million and 0.0 million shares upon the vesting of certain performance restricted stock units ("PRSUs"), which were withheld to satisfy tax withholding obligations during the six months ended June 30, 2016 and 2015, respectively. The shares withheld were valued at the closing price of the common stock on the New York Stock Exchange on the vesting date or first business day thereafter, resulting in approximately \$2.0 million and \$1.2 million in treasury stock acquired during the six months ended June 30, 2016 and 2015, respectively.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(c) Accumulated Other Comprehensive Loss ("AOCL"). AOCL consisted of the following:

(in millions)	Three Months		Six Months	
	Ended June 30, 2016	2015	Ended June 30, 2016	2015
Foreign Currency Translation				
Balance at beginning of period	\$(96.3)	\$(91.6)	\$(115.4)	\$(54.0)
Other comprehensive (loss) income:				
Foreign currency translation adjustments ⁽¹⁾	(2.3)	7.2	16.8	(30.4)
Balance at end of period	\$(98.6)	\$(84.4)	\$(98.6)	\$(84.4)
Interest Rate Swap Agreement				
Balance at beginning of period	\$—	\$(0.6)	\$—	\$(0.7)
Other comprehensive income (loss):				
Net change from period revaluations	—	0.8	—	1.5
Tax expense ⁽²⁾	—	(0.3)	—	(0.6)
Total other comprehensive income before reclassifications, net of tax	\$—	\$0.5	\$—	\$0.9
Net amount reclassified to earnings ⁽³⁾	—	(0.5)	—	(1.0)
Tax benefit ⁽²⁾	—	0.2	—	0.4
Total amount reclassified from accumulated other comprehensive loss, net of tax	\$—	\$(0.3)	\$—	\$(0.6)
Total other comprehensive income	—	0.2	—	0.3
Balance at end of period	\$—	\$(0.4)	\$—	\$(0.4)
Pensions				
Balance at beginning of period	\$(1.4)	\$(2.4)	\$(1.4)	\$(2.4)
Other comprehensive loss:				
Net change from period revaluations	—	(0.1)	—	(0.1)
Balance at end of period	\$(1.4)	\$(2.5)	\$(1.4)	\$(2.5)
Foreign Exchange Forward Contracts				
Balance at beginning of period	\$1.7	\$2.6	\$6.6	\$1.3
Other comprehensive (loss) income:				
Net change from period revaluations	(0.3)	1.1	(5.3)	4.8
Tax benefit (expense) ⁽²⁾	0.1	(0.2)	1.4	(1.2)
Total other comprehensive (loss) income before reclassifications, net of tax	\$(0.2)	\$0.9	\$(3.9)	\$3.6
Net amount reclassified to earnings ⁽⁴⁾	(1.1)	(1.3)	(2.7)	(3.2)
Tax benefit ⁽²⁾	0.3	0.3	0.7	0.8
Total amount reclassified from accumulated other comprehensive loss, net of tax	\$(0.8)	\$(1.0)	\$(2.0)	\$(2.4)
Total other comprehensive (loss) income	(1.0)	(0.1)	(5.9)	1.2
Balance at end of period	\$0.7	\$2.5	\$0.7	\$2.5

(1) In 2016 and 2015, no amounts were reclassified to earnings.

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

(3) This amount was included in interest expense, net on the accompanying Condensed Consolidated Statements of Income.

(4)

This amount was included in cost of sales, net on the accompanying Condensed Consolidated Statements of Income.

(7) Stock-Based Compensation

The Company's stock-based compensation expense for the three and six months ended June 30, 2016 and 2015 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 in the following table.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2016	2015	2016	2015
PRSU expense	\$1.7	\$5.4	\$4.2	\$7.4
Option expense	1.1	2.0	2.8	3.5
RSU/DSU expense	1.7	0.2	3.6	0.7
Total stock-based compensation expense	\$4.5	\$7.6	\$10.6	\$11.6

In the six months ended June 30, 2016, the Company recorded \$2.0 million of accelerated amortization associated with executive management transition. The Company recorded \$4.0 million of accelerated amortization associated with executive management transition for the three and six months ended June 30, 2015.

The Company has 1.3 million PRSUs outstanding that will vest if the Company achieves more than \$650 million of Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") for 2017 (the "2017 Aspirational Plan PRSUs"). All of the 2017 Aspirational Plan PRSUs will vest in full if the Company achieves Adjusted EBITDA in 2017 greater than \$650 million. In addition, if this target is not met in 2017 but the Company achieves more than \$650 million in Adjusted EBITDA for 2018, then one-third of the total 2017 Aspirational Plan PRSUs will vest, and the remaining 2017 Aspirational Plan PRSUs will be forfeited. If the Company does not achieve more than \$650 million of Adjusted EBITDA in either 2017 or 2018, then all of the 2017 Aspirational Plan PRSUs will be forfeited. Adjusted EBITDA is defined as the Company's "Consolidated EBITDA" as such term is defined in the Company's 2012 Credit Agreement.

The Company did not record any stock-based compensation expense related to the 2017 Aspirational Plan PRSUs during the three or six months ended June 30, 2016 or 2015, as it is not considered probable that the Company will achieve the specified performance target as of December 31, 2017 or December 31, 2018. The Company will continue to evaluate the probability of achieving the performance condition going forward and record the appropriate expense if necessary. Based on the price of the Company's common stock on the grant date, the total unrecognized compensation expense related to this award if the performance target is met for 2017 is \$92.4 million, which would be expensed over the service period if it becomes probable of achieving the performance condition.

(8) Commitments and Contingencies

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

On October 25, 2013, a suit was filed against Tempur Sealy International and one of its domestic subsidiaries in the United States District Court for the Northern District of California, purportedly on behalf of a proposed class of "consumers" as defined by Cal. Civ. Code § 1761(d) who purchased, not for resale, a Tempur-Pedic mattress or pillow in the State of California. On November 19, 2013, the Company was served for the first time in the case but with an amended petition adding additional class representatives for additional states. The purported classes seek certification of claims under applicable state laws.

The complaint alleges that the Company engaged in unfair business practices, false advertising, and misrepresentations or omissions related to the sale of certain products. The plaintiffs seek restitution, injunctive relief

and all other relief allowed under applicable state laws, interest, attorneys' fees and costs. The purported classes do not seek damages for physical injuries. The Company believes the case lacks merit and intends to defend against the claims vigorously. The Court was scheduled to consider class certification motions in the fourth quarter of 2015; however, the plaintiffs filed a Motion to Amend the Complaint, at which time the Company filed a Motion to Dismiss the Amended Complaint. A hearing on the Motion to Dismiss was held January 28, 2016 and the Court denied in part and granted in part the Company's Motion to Dismiss, allowing certain claims to proceed. The Court is now scheduled to consider class certification motions in the fourth quarter of 2016. The outcome of this case remains 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.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(b) 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 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 does not believe this matter is material to the Company's financial statements.

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 does not believe the contamination on this site is attributable to the Company's operations, or that it will have a material effect on the Company's financial statements.

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.

The Company cannot predict the ultimate timing or costs of the South Brunswick, Oakville and Putnam 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.

(c) Income Tax Assessments. We have 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. For more information please refer to Note 9, "Income Taxes", in our Condensed Consolidated Financial Statements.

(d) 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.

(9) Income Taxes

The Company's effective tax rate for the three months ended June 30, 2016 and 2015 was 31.5% and 28.3%, respectively. The Company's effective tax rate for the six months ended June 30, 2016 and 2015 was 31.0% and 28.8%, respectively. The Company's income tax rate for the three and six months ended June 30, 2016 and 2015 differed from the U.S. federal statutory rate of 35.0% principally due to certain foreign income tax rate differentials, state and local income taxes, the production activities deduction, certain other permanent differences, and changes in the Company's uncertain tax positions.

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

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The cumulative total tax assessment at June 30, 2016 for all years for which an assessment has been received (2001 - 2008) is approximately Danish Krone ("DKK") 1,501.7 million, including interest and penalties (\$223.8 million, based on the DKK to USD exchange rate on June 30, 2016). The cumulative total tax assessment at December 31, 2015 for all years for which an assessment had been received up through that date (2001 - 2008) including interest and penalties was approximately DKK 1,363.1 million (\$199.6 million, based on the DKK to USD exchange rate on December 31, 2015). If SKAT continues to issue assessments for each year not currently assessed, the Company expects the aggregate assessments for such years (2009 - 2015) to be in excess of the amounts described above as assessed for the years 2001 - 2008.

The Company and SKAT continued negotiations with respect to this matter in the second quarter of 2016 and the Company expects such negotiations to continue into the third quarter of 2016. At June 30, 2016, the Company had accrued approximately \$79.0 million for this matter, which was adjusted to reflect additional interest during the second quarter of 2016. In July 2016, the Company paid a deposit to SKAT consistent with its reserve position for this royalty matter to mitigate additional interest and foreign exchange exposure. The uncertain tax liability reflects the Company's best judgment of the facts, circumstances and information available through June 30, 2016.

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

From June 2012 through June 30, 2016, SKAT withheld Value Added Tax refunds otherwise owed to the Company, pending resolution of this matter. Total withheld refunds at June 30, 2016 and December 31, 2015 are approximately \$32.6 million and \$26.0 million, respectively, and are included within other non-current assets on the Condensed Consolidated Balance Sheets.

Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. It is reasonably possible that there could be material changes to the amount of uncertain tax positions due to activities of the taxing authorities, settlement of audit issues, reassessment of existing uncertain tax positions, including the Danish tax matter, or the expiration of applicable statute of limitations; however, the Company is not able to estimate the impact of these items at this time. There were no significant changes to the liability for unrecognized tax benefits during the three months ended June 30, 2016.

(10) Major Customers

On February 5, 2016, Mattress Firm Holding Corp. ("Mattress Firm") acquired all of the outstanding equity interests in HMK Mattress Holdings, LLC ("Sleepy's"). Sleepy's has historically been one of the Company's top five customers and, as a result of this acquisition, the combined companies represented 23.8% and 25.8% of the Company's sales for the three months ended June 30, 2016 and 2015, respectively. Net sales for the combined companies represented 22.4% and 24.0% of the Company's sales for the six months ended June 30, 2016 and 2015. Net sales from this customer are included in the North America segment.

The top five customers, including the impact of the Mattress Firm acquisitions, accounted for approximately 40.4% and 42.8% of the Company's sales for the three months ended June 30, 2016 and 2015, respectively. The top five customers, including the impact of the Mattress Firm acquisition of Sleepy's and prior acquisitions, accounted for approximately 40.5% and 42.0% of the Company's sales for the six months ended June 30, 2016 and 2015, respectively. The top five customers, including the impact of the Mattress Firm acquisitions, accounted for approximately 40.9%, 37.7% and 41.9% of accounts receivable, net as of June 30, 2016, December 31, 2015 and June 30, 2015, respectively.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(11) Earnings Per Common Share

The following table sets forth the components of the numerator and denominator for the computation of basic and diluted earnings per share for net income attributable to Tempur Sealy International. As presented on the Company's Condensed Consolidated Statements of Income, the Company has included the effect of the \$(0.1) million and \$0.9 million Comfort Revolution redemption value adjustment, net of tax, for the three and six months ended June 30, 2015 in Net income attributable to Tempur Sealy International, Inc. below. As of June 30, 2016, the accumulated earnings exceeded the redemption value and, accordingly, a redemption value adjustment was not necessary for the three or six months ended June 30, 2016.

	Three Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
(in millions, except per common share amounts)				
Numerator:				
Net income attributable to Tempur Sealy International, Inc.	\$21.3	\$21.2	\$60.9	\$44.6
Denominator:				
Denominator for basic earnings per common share-weighted average shares	60.2	61.3	61.1	61.1
Effect of dilutive securities:				
Employee stock-based compensation	0.6	1.1	0.6	1.2
Denominator for diluted earnings per common share-adjusted weighted average shares	60.8	62.4	61.7	62.3
Basic earnings per common share	\$0.35	\$0.35	\$1.00	\$0.73
Diluted earnings per common share	\$0.35	\$0.34	\$0.99	\$0.72

The Company excluded 0.4 million and 0.1 million shares issuable upon exercise of outstanding stock options for the three months ended June 30, 2016 and 2015, respectively, from the diluted earnings per common share computation because their exercise price was greater than the average market price of Tempur Sealy International's common stock or they were otherwise anti-dilutive. The Company excluded 0.4 million shares issuable upon exercise of outstanding stock options for the six months ended June 30, 2016 and 2015 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.

(12) Business Segment Information

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

The Company's North America and International segment assets include investments in subsidiaries that are appropriately eliminated in the Company's accompanying Condensed Consolidated Financial Statements. The

remaining inter-segment eliminations are comprised of intercompany accounts receivable and payables.

20

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The following table summarizes total assets by segment:

	June 30,	December
(in millions)	2016	31, 2015
North America	\$2,577.4	\$2,533.1
International	521.6	477.1
Corporate	700.7	775.0
Inter-segment eliminations	(1,080.3)	(1,129.7)
Total assets	\$2,719.4	\$2,655.5

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

	June	December
(in millions)	30, 2016	31, 2015
North America	\$237.8	\$ 239.2
International	54.3	54.8
Corporate	70.1	67.7
Total property, plant and equipment, net	\$362.2	\$ 361.7

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

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Bedding sales	\$ 636.2	\$ 108.6	\$ —	\$ —	\$ 744.8
Other sales	32.0	27.6	—	—	59.6
Net sales	668.2	136.2	—	—	804.4
Inter-segment sales	\$ 1.3	\$ 0.1	\$ —	\$ (1.4)	\$ —
Inter-segment royalty expense (income)	2.1	(2.1)	—	—	—
Gross profit	267.3	69.6	—	—	336.9
Operating income (loss)	103.3	23.2	(26.3)	—	100.2
Income (loss) before income taxes	100.2	21.0	(92.0)	—	29.2
Depreciation and amortization ⁽¹⁾	\$ 10.9	\$ 3.9	\$ 8.1	\$ —	\$ 22.9
Capital expenditures	5.7	2.4	3.6	—	11.7

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

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The following table summarizes segment information for the three months ended June 30, 2015:

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Bedding sales	\$ 604.8	\$ 106.6	\$ —	\$ —	\$ 711.4
Other sales	25.5	27.5	—	—	53.0
Net sales	630.3	134.1	—	—	764.4
Inter-segment sales	\$ 1.8	\$ 0.2	\$ —	\$ (2.0)	\$ —
Inter-segment royalty expense (income)	1.8	(1.8)	—	—	—
Gross profit	227.4	70.1	—	—	297.5
Operating income (loss)	64.6	23.7	(36.3)	—	52.0
Income (loss) before income taxes	62.1	20.8	(53.6)	—	29.3
Depreciation and amortization ⁽¹⁾	\$ 11.6	\$ 4.1	\$ 10.8	\$ —	\$ 26.5
Capital expenditures	9.9	3.3	5.4	—	18.6

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

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

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Bedding sales	\$1,190.6	\$ 221.7	\$ —	\$ —	\$ 1,412.3
Other sales	57.6	55.5	—	—	113.1
Net sales	1,248.2	277.2	—	—	1,525.4
Inter-segment sales	\$2.5	\$ 0.1	\$ —	\$ (2.6)	\$ —
Inter-segment royalty expense (income)	3.8	(3.8)	—	—	—
Gross profit	481.8	146.1	—	—	627.9
Operating income (loss)	180.6	50.5	(54.2)	—	176.9
Income (loss) before income taxes	177.2	45.4	(137.1)	—	85.5
Depreciation and amortization ⁽¹⁾	\$21.2	\$ 7.8	\$ 17.6	\$ —	\$ 46.6
Capital expenditures	11.3	4.7	8.3	—	24.3

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

The following table summarizes segment information for the six months ended June 30, 2015:

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Bedding sales	\$1,163.4	\$ 223.7	\$ —	\$ —	\$ 1,387.1
Other sales	61.0	55.8	—	—	116.8
Net sales	1,224.4	279.5	—	—	1,503.9
Inter-segment sales	\$3.5	\$ 0.3	\$ —	\$ (3.8)	\$ —
Inter-segment royalty expense (income)	3.3	(3.3)	—	—	—
Gross profit	430.5	145.7	—	—	576.2
Operating income (loss)	122.5	49.0	(65.1)	—	106.4
Income (loss) before income taxes	118.6	46.1	(100.1)	—	64.6

Depreciation and amortization ⁽¹⁾	\$22.2	\$ 8.1	\$ 18.0	\$ —	\$ 48.3
Capital expenditures	18.1	5.4	10.5	—	34.0

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

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

	June	December
(in millions)	30,	31,
	2016	2015
United States	\$300.8	\$ 300.1
Canada	7.1	6.8
Other International	54.3	54.8
Total property, plant and equipment, net	\$362.2	\$ 361.7
Total International	\$61.4	\$ 61.6

The following table summarizes net sales by geographic region:

	Three Months		Six Months Ended	
(in millions)	Ended		June 30,	
	June 30,	June 30,	June 30,	June 30,
	2016	2015	2016	2015
United States	\$614.1	\$580.9	\$1,151.3	\$1,128.6
Canada	54.1	49.4	96.9	95.8
Other International	136.2	134.1	277.2	279.5
Total net sales	\$804.4	\$764.4	\$1,525.4	\$1,503.9
Total International	\$190.3	\$183.5	\$374.1	\$375.3

(13) Guarantor/Non-Guarantor Financial Information

The \$375.0 million, \$450.0 million and \$600 million aggregate principal amount of 2020 Senior Notes, 2023 Senior Notes, and 2026 Senior Notes (collectively the "Senior Notes"), respectively, are general unsecured senior obligations of Tempur Sealy International and are fully and unconditionally guaranteed on a senior unsecured basis, jointly and severally, by all of Tempur Sealy International's 100% directly or indirectly owned current and future domestic subsidiaries (the "Combined Guarantor Subsidiaries"). The foreign subsidiaries (the "Combined Non-Guarantor Subsidiaries") represent the foreign operations of the Company and do not guarantee the Senior Notes. A subsidiary guarantor will be released from its obligations under the applicable indenture governing the Senior Notes when: (a) the subsidiary guarantor is sold or sells all or substantially all of its assets; (b) the subsidiary is declared "unrestricted" under the applicable indenture governing the Senior Notes; (c) the subsidiary's guarantee of indebtedness under the 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 applicable indenture have been satisfied. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions, including transactions with the Company's wholly-owned subsidiary guarantors and non-guarantor subsidiaries. The Company has accounted for its investments in its subsidiaries under the equity method.

The following financial information presents the Condensed Consolidated Statements of Income and Comprehensive Income for the three and six months ended June 30, 2016 and 2015, the Supplemental Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015, and the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015 for Tempur Sealy International, Combined Guarantor Subsidiaries and Combined Non-Guarantor Subsidiaries.

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended June 30, 2016

(in millions)

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

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended June 30, 2015

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$ —	\$ 592.5	\$ 184.2	\$ (12.3)	\$ 764.4
Cost of sales	—	378.7	100.5	(12.3)	466.9
Gross profit	—	213.8	83.7	—	297.5
Selling and marketing expenses	0.9	123.3	44.4	—	168.6
General, administrative and other expenses	7.3	60.9	16.9	—	85.1
Equity income in earnings of unconsolidated affiliates	—	—	(3.4)	—	(3.4)
Royalty income, net of royalty expense	—	(4.8)	—	—	(4.8)
Operating (loss) income	(8.2)	34.4	25.8	—	52.0
Other expense, net:					
Third party interest expense, net	6.7	13.2	0.6	—	20.5
Intercompany interest expense (income), net	8.2	(8.9)	0.7	—	—
Interest expense, net	14.9	4.3	1.3	—	20.5
Other expense, net	—	0.6	1.6	—	2.2
Total other expense, net	14.9	4.9	2.9	—	22.7
Income from equity investees	37.4	17.7	—	(55.1)	—
Income before income taxes	14.3	47.2	22.9	(55.1)	29.3
Income tax benefit (provision)	6.7	(9.8)	(5.2)	—	(8.3)
Net income before non-controlling interest	21.0	37.4	17.7	(55.1)	21.0
Less: Net loss attributable to non-controlling interest	(0.2)	(0.2)	—	0.2	(0.2)
Net income attributable to Tempur Sealy International, Inc.	\$ 21.2	\$ 37.6	\$ 17.7	\$ (55.3)	\$ 21.2
Comprehensive income attributable to Tempur Sealy International, Inc.	\$ 28.4	\$ 37.4	\$ 25.4	\$ (62.8)	\$ 28.4

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Six Months Ended June 30, 2016

(in millions)

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

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Six Months Ended June 30, 2015

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$ —	\$ 1,151.3	\$ 377.1	\$ (24.5)	\$ 1,503.9
Cost of sales	—	746.4	205.8	(24.5)	927.7
Gross profit	—	404.9	171.3	—	576.2
Selling and marketing expenses	1.7	228.7	92.0	—	322.4
General, administrative and other expenses	11.1	118.3	33.4	—	162.8
Equity income in earnings of unconsolidated affiliates	—	—	(6.4)	—	(6.4)
Royalty income, net of royalty expense	—	(9.0)	—	—	(9.0)
Operating (loss) income	(12.8)	66.9	52.3	—	106.4
Other expense, net:					
Third party interest expense, net	13.4	26.2	1.3	—	40.9
Intercompany interest expense (income), net	16.4	(17.7)	1.3	—	—
Interest expense, net	29.8	8.5	2.6	—	40.9
Other expense, net	—	0.5	0.4	—	0.9
Total other expense, net	29.8	9.0	3.0	—	41.8
Income from equity investees	75.0	38.6	—	(113.6)	—
Income before income taxes	32.4	96.5	49.3	(113.6)	64.6
Income tax benefit (provision)	13.6	(21.5)	(10.7)	—	(18.6)
Net income before non-controlling interest	46.0	75.0	38.6	(113.6)	46.0
Less: Net income attributable to non-controlling interest	1.4	1.4	—	(1.4)	1.4
Net income attributable to Tempur Sealy International, Inc.	\$ 44.6	\$ 73.6	\$ 38.6	\$ (112.2)	\$ 44.6
Comprehensive income attributable to Tempur Sealy International, Inc.	\$ 15.6	\$ 73.6	\$ 7.1	\$ (80.7)	\$ 15.6

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Balance Sheets

June 30, 2016

(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	\$ —	\$ 61.9	\$ 76.0	\$—	\$ 137.9
Accounts receivable, net	—	276.5	137.5	—	414.0
Inventories, net	—	167.6	58.0	—	225.6
Income taxes receivable	219.9	—	—	(219.9)	—
Prepaid expenses and other current assets	0.5	46.8	24.1	—	71.4
Total Current Assets	220.4	552.8	295.6	(219.9)	848.9
Property, plant and equipment, net	—	300.8	61.4	—	362.2
Goodwill	—	501.4	218.2	—	719.6
Other intangible assets, net	—	606.3	85.6	—	691.9
Deferred income taxes	19.2	—	12.5	(19.2)	12.5
Other non-current assets	—	30.9	53.4	—	84.3
Net investment in subsidiaries	2,096.1	—	—	(2,096.1)	—
Due from affiliates	505.3	1,688.2	5.0	(2,198.5)	—
Total Assets	\$ 2,841.0	\$ 3,680.4	\$ 731.7	\$(4,533.7)	\$ 2,719.4
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Accounts payable	\$ 6.7	\$ 195.1	\$ 51.7	\$—	\$ 253.5
Accrued expenses and other current liabilities	8.9	186.4	68.4	—	263.7
Income taxes payable	—	215.8	5.2	(219.9)	1.1
Current portion of long-term debt	—	146.9	3.3	—	150.2
Total Current Liabilities	15.6	744.2	128.6	(219.9)	668.5
Long-term debt, net	1,039.7	486.9	—	—	1,526.6
Deferred income taxes	—	191.4	22.4	(19.2)	194.6
Other non-current liabilities	—	156.4	5.3	—	161.7
Due to affiliates	1,617.7	5.4	579.1	(2,202.2)	—
Total Liabilities	2,673.0	1,584.3	735.4	(2,441.3)	2,551.4
Redeemable non-controlling interest	10.5	10.5	—	(10.5)	10.5
Total Stockholders' Equity	157.5	2,085.6	(3.7)	(2,081.9)	157.5
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	\$ 2,841.0	\$ 3,680.4	\$ 731.7	\$(4,533.7)	\$ 2,719.4

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Balance Sheets

December 31, 2015

(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	\$ —	\$ 121.8	\$ 32.1	\$—	\$ 153.9
Accounts receivable, net	—	231.9	147.5	—	379.4
Inventories, net	—	145.3	53.9	—	199.2
Income taxes receivable	193.1	—	—	(193.1)	—
Prepaid expenses and other current assets	—	43.5	33.1	—	76.6
Total Current Assets	193.1	542.5	266.6	(193.1)	809.1
Property, plant and equipment, net	—	300.1	61.6	—	361.7
Goodwill	—	501.4	208.0	—	709.4
Other intangible assets, net	—	612.9	82.5	—	695.4
Deferred income taxes	16.0	—	12.2	(16.0)	12.2
Other non-current assets	—	23.3	44.4	—	67.7
Net investment in subsidiaries	1,960.5	—	—	(1,960.5)	—
Due from affiliates	548.1	1,655.3	4.8	(2,208.2)	—
Total Assets	\$ 2,717.7	\$ 3,635.5	\$ 680.1	\$ (4,377.8)	\$ 2,655.5
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Accounts payable	\$ —	\$ 212.2	\$ 54.1	\$—	\$ 266.3
Accrued expenses and other current liabilities	1.4	183.8	68.8	—	254.0
Income taxes payable	—	196.0	8.3	(193.1)	11.2
Current portion of long-term debt	—	168.7	12.8	—	181.5
Total Current Liabilities	1.4	760.7	144.0	(193.1)	713.0
Long-term debt, net	811.9	461.4	—	—	1,273.3
Deferred income taxes	—	189.8	21.6	(16.0)	195.4
Other non-current liabilities	—	166.6	4.6	—	171.2
Due to affiliates	1,601.8	96.5	604.9	(2,303.2)	—
Total Liabilities	2,415.1	1,675.0	775.1	(2,512.3)	2,352.9
Redeemable non-controlling interest	12.4	12.4	—	(12.4)	12.4
Total Stockholders' Equity	290.2	1,948.1	(95.0)	(1,853.1)	290.2
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	\$ 2,717.7	\$ 3,635.5	\$ 680.1	\$ (4,377.8)	\$ 2,655.5

Table of Contents

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Cash Flows

Six Months Ended June 30, 2016

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash (used in) provided by operating activities	\$ (29.9)	\$ 32.3	\$ 49.5	\$ —	—\$ 51.9
CASH FLOWS FROM INVESTING ACTIVITIES:					
Purchase of property, plant and equipment	—	(19.4)	(4.9)	—	(24.3)
Contributions (paid to) received from subsidiaries and affiliates	—	(40.1)	40.1	—	—
Net cash (used in) provided by investing activities	—	(59.5)	35.2	—	(24.3)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Proceeds from borrowings under long-term debt obligations	600.0	830.1	5.2	—	1,435.3
Repayments of borrowings under long-term debt obligations	(375.0)	(839.6)	(15.8)	—	(1,230.4)
Net activity in investment in and advances from (to) subsidiaries and affiliates	45.7	(17.1)	(28.6)	—	—
Proceeds from exercise of stock options	6.0	—	—	—	6.0
Excess tax benefit from stock-based compensation	3.0	—	—	—	3.0
Treasury stock repurchased	(217.3)	—	—	—	(217.3)
Payment of deferred financing costs	(2.9)	(3.3)	—	—	(6.2)
Fees paid to lenders	(6.0)	(1.8)	—	—	(7.8)
Call premium on 2020 Senior Notes	(23.6)	—	—	—	(23.6)
Other	—	(1.0)	1.4	—	0.4
Net cash provided by (used in) financing activities	29.9	(32.7)	(37.8)	—	(40.6)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS					
(Decrease) increase in cash and cash equivalents	—	(59.9)	43.9	—	(16.0)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	—	121.8	32.1	—	153.9
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ —	\$ 61.9	\$ 76.0	\$ —	—\$ 137.9

Table of Contents

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, 2015

(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	\$ (49.6)	\$ 31.6	\$ 19.1	\$	—\$ 1.1
CASH FLOWS FROM INVESTING ACTIVITIES:					
Purchases of property, plant and equipment	—	(27.8)	(6.2)	—	(34.0)
Proceeds from disposition of business and other	—	7.2	(0.1)	—	7.1
Net cash used in investing activities	—	(20.6)	(6.3)	—	(26.9)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Proceeds from borrowings under long-term debt obligations	—	283.0	—	—	283.0
Repayments of borrowings under long-term debt obligations	—	(311.5)	—	—	(311.5)
Net activity in investment in and advances from (to) subsidiaries and affiliates	25.2	3.1	(28.3)	—	—
Proceeds from exercise of stock options	10.5	—	—	—	10.5
Excess tax benefit from stock-based compensation	14.7	—	—	—	14.7
Treasury stock repurchased	(1.2)	—	—	—	(1.2)
Other	—	(2.1)	0.9	—	(1.2)
Net cash provided by (used in) financing activities	49.2	(27.5)	(27.4)	—	(5.7)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS					
Decrease in cash and cash equivalents	(0.4)	(16.5)	(10.2)	—	(27.1)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	0.4	25.5	36.6	—	62.5
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ —	\$ 9.0	\$ 26.4	\$	—\$ 35.4

Table of Contents

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

The following discussion and analysis should be read in conjunction with our Annual Report on Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in ITEM 7 of Part II of the Annual Report, and accompanying Condensed Consolidated Financial Statements and accompanying notes included in this Form 10-Q. Unless otherwise noted, all of the financial information in this Report is consolidated financial information for the Company. The forward-looking statements in this discussion regarding the mattress and pillow industries, our expectations regarding our strategy, our future performance, liquidity and capital resources and other non-historical statements in this discussion are subject to numerous risks and uncertainties. See "Special Note Regarding Forward-Looking Statements" and "Risk Factors" elsewhere in this quarterly report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2015. Our actual results may differ materially from those contained in any forward-looking statements.

In this discussion and analysis, we discuss and explain the consolidated financial condition and results of operations for the three and six months ended June 30, 2016, including the following topics:

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

Business Overview

General

We are the world's largest bedding provider. We develop, manufacture, market and distribute bedding products, which we sell globally in approximately 100 countries. Our brand portfolio includes many highly recognized brands in the industry, including TEMPUR®, Tempur-Pedic®, Sealy®, Sealy Posturepedic® and Stearns & Foster®. Our comprehensive suite of bedding products offers a variety of products to consumers across a broad range of channels.

Our Channels

We sell our products through two distribution channels in each segment: Retail (furniture and bedding retailers, department stores, specialty retailers and warehouse clubs); and Other (direct-to-consumer through e-commerce platforms, Company-owned stores and call centers, third party distributors, hospitality and healthcare customers).

Segments

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

Factors That Could Impact Results of Operations

Please refer to "Risk Factors", under ITEM 1A of Part II and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors That Could Impact Results of Operations" included in ITEM 7 of Part II of our Annual Report on Form 10-K for the year ended December 31, 2015 for a discussion of the factors that could impact our future results of operations.

Table of Contents

Results of Operations

A summary of our results for the three months ended June 30, 2016 include:

Total net sales increased 5.2% to \$804.4 million from \$764.4 million in the second quarter of 2015. On a constant currency basis, which is a non-GAAP financial measure, total net sales increased 6.6%, with an increase of 6.4% in the North America segment and an increase of 7.6% in the International segment.

Gross margin was 41.9% as compared to 38.9% in the second quarter of 2015.

Operating income increased 92.7% to \$100.2 million as compared to \$52.0 million in the second quarter of 2015.

Operating income in the second quarter of 2016 included \$1.0 million of integration costs. Operating income in the second quarter of 2015 included \$6.7 million of integration costs and \$11.7 million of additional costs related to the Company's 2015 Annual Meeting and related executive management transition and retention compensation.

Earnings before interest, tax, depreciation and amortization ("EBITDA"), which is a non-GAAP financial measure, increased 61.7% to \$123.7 million as compared to \$76.5 million for the second quarter of 2015. Adjusted EBITDA, which is a non-GAAP financial measure, increased 38.1% to \$124.7 million as compared to \$90.3 million in the second quarter of 2015.

The Company incurred a \$47.2 million loss on extinguishment of debt in the second quarter of 2016 associated with the completion of the 2016 Credit Agreement, issuance of the 2026 Senior Notes and redemption of the 2020 Senior Notes.

Net income increased 0.5% to \$21.3 million as compared to \$21.2 million in the second quarter of 2015.

Earnings per diluted share ("EPS") was \$0.35 as compared to \$0.34 in the second quarter of 2015.

A summary of our results for the six months ended June 30, 2016 include:

Net sales increased 1.4% to \$1,525.4 million from \$1,503.9 million in the six months ended June 30, 2015, driven by new product introductions in the North America segment. On a constant currency basis, total net sales increased 3.3%.

Net income increased 36.5% to \$60.9 million from \$44.6 million in the six months ended June 30, 2015.

EPS increased 37.5% to \$0.99 from \$0.72 in the six months ended June 30, 2015.

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

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

Table of Contents

THREE MONTHS ENDED JUNE 30, 2016 COMPARED TO THE THREE MONTHS ENDED JUNE 30, 2015

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

(in millions, except per share amounts)	Three Months Ended June 30,			
	2016		2015	
Net sales	\$804.4	100.0 %	\$764.4	100.0 %
Cost of sales	467.5	58.1	466.9	61.1
Gross profit	336.9	41.9	297.5	38.9
Selling and marketing expenses	172.8	21.5	168.6	22.1
General, administrative and other expenses	71.9	8.9	85.1	11.1
Equity income in earnings of unconsolidated affiliates	(3.4)	(0.4)	(3.4)	(0.4)
Royalty income, net of royalty expense	(4.6)	(0.6)	(4.8)	(0.7)
Operating income	100.2	12.5	52.0	6.8
Other expense, net:				
Interest expense, net	23.1	2.9	20.5	2.7
Loss on extinguishment of debt	47.2	5.9	—	—
Other income, net	0.7	—	2.2	0.3
Total other expense, net	71.0	8.8	22.7	3.0
Income before income taxes	29.2	3.6	29.3	3.8
Income tax provision	(9.2)	(1.1)	(8.3)	(1.0)
Net income before non-controlling interest	20.0	2.5	21.0	2.8
Less: Net loss attributable to non-controlling interest ⁽¹⁾	(1.3)	(0.2)	(0.2)	—
Net income attributable to Tempur Sealy International, Inc.	\$21.3	2.6 %	\$21.2	2.8 %
Earnings per common share:				
Basic	\$0.35		\$0.35	
Diluted	\$0.35		\$0.34	
Weighted average common shares outstanding:				
Basic	60.2		61.3	
Diluted	60.8		62.4	

Loss attributable to the Company's redeemable non-controlling interest in Comfort Revolution, LLC for the three months ended June 30, 2016 and 2015 represented \$(1.3) million and \$(0.1) million, respectively. As of June 30, 2015, the redemption value exceeded the accumulated earnings of the Company's redeemable non-controlling (1) interest in Comfort Revolution, LLC. Accordingly, for the three months ended June 30, 2015, the Company recorded a \$(0.1) million adjustment, net of tax, to adjust the carrying value of redeemable non-controlling interest to its redemption value. As of June 30, 2016, the accumulated earnings exceeded the redemption value and, accordingly, a redemption value adjustment was not necessary for the three months ended June 30, 2016.

Table of Contents

NET SALES

(in millions)	Three Months Ended June 30,					
	2016		2015		2016	
	Consolidated	North America	International	Consolidated	North America	International
Net sales by channel						
Retail channel	\$725.5	\$703.7	\$630.9	\$608.3	\$94.6	\$95.4
Other channel	78.9	60.7	37.3	22.0	41.6	38.7
Total net sales	\$804.4	\$764.4	\$668.2	\$630.3	\$136.2	\$134.1
Net sales by product						
Bedding	\$744.8	\$711.4	\$636.2	\$604.8	\$108.6	\$106.6
Other products	59.6	53.0	32.0	25.5	27.6	27.5
Total net sales	\$804.4	\$764.4	\$668.2	\$630.3	\$136.2	\$134.1

Net sales increased 5.2%, and on a constant currency basis increased 6.6%. The increase in net sales was driven by:

North America net sales increased 6.0%. On a constant currency basis, net sales increased approximately 6.4%. Net sales of Bedding products increased \$31.4 million, or 5.2%, primarily due to the success of new product introductions and expanded distribution. Net sales of Other products increased \$6.5 million, or 25.5%, primarily as a result of an increase in net sales through our U.S. joint venture. Canada net sales increased 9.5% and, on a constant currency basis, increased 15.0%.

International net sales increased 1.6%. On a constant currency basis, International net sales increased approximately 7.6%, with growth across all major regions. The increase in net sales was primarily due to the success of new product introductions, an increase in direct sales of our Tempur products in Asia-Pacific and an increase in net sales of our Sealy products in Latin America. International Other channel sales increased 16.5% on a constant currency basis, primarily driven by increases in net sales through the Internet and our company-owned stores.

GROSS PROFIT

(in millions, except percentages)	Three Months Ended June 30,					
	2016		2015		Margin Change	
	Gross Profit	Gross Margin	Gross Profit	Gross Margin		
North America	\$267.3	40.0 %	\$227.4	36.1 %	3.9	%
International	69.6	51.1 %	70.1	52.3 %	(1.2)	%
Consolidated gross margin	\$336.9	41.9 %	\$297.5	38.9 %	3.0	%

Costs associated with net sales are recorded in cost of sales and include the costs of producing, shipping, warehousing, receiving and inspecting goods during the period, as well as depreciation and amortization of long-lived assets used in the manufacturing process. The principal factors impacting gross profit and gross margin for each segment are discussed below in the respective segment discussions.

Gross margin increased 300 basis points. The increase was primarily driven by 150 basis points of operational improvements, including sourcing improvements and decreased commodity costs. In addition, gross margin improved 150 basis points due to pricing actions and product mix. Gross margin also improved 50 basis points due to a decrease in expenses related to the transition of manufacturing and distribution facilities. These factors were partially offset by unfavorable discounts on new product introductions of 40 basis points, as our product introductions in the second quarter of 2016 were more significant than in 2015.

North America gross margin increased 390 basis points. The increase was driven primarily by 190 basis points of operational improvements, including sourcing improvements and decreased commodity costs. In addition, gross margin improved 190 basis points due to pricing actions and product mix. Gross margin also improved 50 basis points due to a decrease in expenses related to the transition of manufacturing and distribution facilities. These factors were partially offset by un

35

Table of Contents

favorable discounts on new product introductions of 50 basis points, as our product introductions in the second quarter of 2016 were more significant than in 2015.

International gross margin decreased 120 basis points. The decrease was driven primarily by 60 basis points of costs associated with product introductions, and 30 basis points of unfavorable product mix. Gross margin was also impacted by an increase in net sales of Sealy products sold in our International segment relative to net sales of Tempur products, which negatively impacts our gross margin, as well as unfavorable foreign exchange rates. These factors were slightly offset by a 30 basis point improvement in channel mix, as we expand distribution through more profitable direct-to-consumer channels.

OPERATING EXPENSES

(in millions)	Three Months Ended June 30,							
	2016	2015	2016	2015	2016	2015	2016	2015
	Consolidated		North America		International		Corporate	
Operating expenses:								
Advertising expenses	\$93.8	\$96.3	\$86.0	\$87.9	\$7.8	\$8.4	\$—	\$—
Other selling and marketing expenses	79.0	72.3	47.4	41.7	30.7	29.7	0.9	0.9
General, administrative and other expenses	71.9	85.1	32.5	35.3	14.0	14.4	25.4	35.4
Total operating expenses	\$244.7	\$253.7	\$165.9	\$164.9	\$52.5	\$52.5	\$26.3	\$36.3

Selling and marketing expenses include advertising and media production associated with the promotion of our brands, other marketing materials such as catalogs, brochures, videos, product samples, direct customer mailings and point of purchase materials, and sales force compensation. We also include in selling and marketing expenses certain new product development costs, including market research and new product testing.

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

Operating expenses decreased \$9.0 million or 3.5%, and decreased 280 basis points as a percentage of net sales. In the second half of 2015, we took actions to reduce our overhead expenses. We expect the impact of these headcount reductions and international store closures will reduce our overall operating expenses by approximately \$3.5 million per quarter in 2016 as compared to 2015. The primary drivers of changes in operating expenses by segment are explained below.

North America operating expenses increased \$1.0 million and decreased 140 basis points as a percentage of net sales. This increase was primarily driven by a \$5.7 million increase in other selling and marketing expenses, primarily due to in-store marketing and media investments associated with new product introductions. This increase was partially offset by a \$2.8 million decrease in general, administrative and other expenses, primarily as a result of a \$1.4 million decrease in research and development costs.

International operating expenses remained relatively flat and decreased slightly as a percentage of net sales.

Corporate operating expenses decreased \$10.0 million, or 27.5%. In the second quarter of 2015, we incurred \$7.4 million of executive management transition and retention compensation and \$4.2 million of additional costs related to our 2015 Annual Meeting and related issues, which were not incurred in the second quarter of 2016. These decreases were partially offset by an increase in performance related compensation expense.

Research and development expenses for the three months ended June 30, 2016 were \$6.9 million compared to \$8.1 million for the three months ended June 30, 2015, a decrease of \$1.2 million, or 14.8%.

Table of Contents

OPERATING INCOME

(in millions, except percentages)	Three Months Ended June 30,					
	2016		2015		Change	
	Operating Income	Operating Margin	Operating Income	Operating Margin	Operating Margin	
North America	\$103.3	15.5 %	\$64.6	10.2 %	5.3 %	
International	23.2	17.0 %	23.7	17.7 %	(0.7)%	
	126.5		88.3			
Corporate expenses	(26.3)		(36.3)			
Total operating income	\$100.2	12.5 %	\$52.0	6.8 %	5.7 %	

Operating income increased \$48.2 million and operating margin improved 570 basis points. The increase was driven by:

North America operating income increased \$38.7 million and operating margin improved 530 basis points. The improvement in operating margin was primarily driven by improved gross margin of 390 basis points and an improvement of operating expense leverage of 140 basis points.

International operating income decreased \$0.5 million and operating margin decreased 70 basis points. The decrease in operating margin was primarily driven by a decrease in gross margin of 120 basis points, offset slightly by an improvement in operating expense leverage of 60 basis points.

INTEREST EXPENSE, NET

(in millions, except percentages)	Three Months Ended June 30,		
	2016	2015	% Change
Interest expense, net	\$23.1	\$20.5	12.7 %

Interest expense, net, increased \$2.6 million or 12.7%. In connection with the overlapping period between the issuance of the 2026 Senior Notes on May 24, 2016 and redemption of the 2020 Senior Notes on June 23, 2016, we incurred an additional \$2.1 million of interest compared to the three months ended June 30, 2015. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

LOSS ON EXTINGUISHMENT OF DEBT

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

Table of Contents

INCOME TAX PROVISION

	Three Months Ended June 30,		
(in millions, except percentages)	2016	2015	% Change
Income tax provision	\$9.2	\$8.3	10.8 %
Effective tax rate	31.5 %	28.3 %	

Income tax provision includes income taxes associated with taxes currently payable and deferred taxes, and includes the impact of net operating losses for certain of our foreign operations.

Our income tax provision increased \$0.9 million due primarily to normal permanent book to tax difference items as well as an increase of income before income taxes, and our effective tax rate increased 320 basis points. For the three months ended June 30, 2016 and 2015, there were no material non-recurring items that impacted the effective tax rate in each period, respectively.

Table of Contents

SIX MONTHS ENDED JUNE 30, 2016 COMPARED TO THE SIX MONTHS ENDED JUNE 30, 2015

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

(in millions, except per share amounts)	Six Months Ended June 30,			
	2016		2015	
Net sales	\$1,525.4	100.0 %	\$1,503.9	100.0 %
Cost of sales	897.5	58.8	927.7	61.7
Gross profit	627.9	41.2	576.2	38.3
Selling and marketing expenses	322.9	21.2	322.4	21.4
General, administrative and other expenses	143.6	9.4	162.8	10.8
Equity income in earnings of unconsolidated affiliates	(6.2)	(0.4)	(6.4)	(0.4)
Royalty income, net of royalty expense	(9.3)	(0.6)	(9.0)	(0.6)
Operating income	176.9	11.6	106.4	7.1
Other expense, net:				
Interest expense, net	44.5	2.9	40.9	2.7
Loss on extinguishment of debt	47.2	3.1	—	—
Other (income) expense, net	(0.3)	—	0.9	0.1
Total other expense, net	91.4	6.0	41.8	2.8
Income before income taxes	85.5	5.6	64.6	4.3
Income tax provision	(26.5)	(1.7)	(18.6)	(1.2)
Net income before non-controlling interest	59.0	3.9	46.0	3.1
Less: Net (loss) income attributable to non-controlling interest ⁽¹⁾	(1.9)	(0.1)	1.4	0.1
Net income attributable to Tempur Sealy International, Inc.	\$60.9	4.0 %	\$44.6	3.0 %
Earnings per common share:				
Basic	\$1.00		\$0.73	
Diluted	\$0.99		\$0.72	
Weighted average common shares outstanding:				
Basic	61.1		61.1	
Diluted	61.7		62.3	

(Loss) income attributable to the Company's redeemable non-controlling interest in Comfort Revolution, LLC for the six months ended June 30, 2016 and 2015 represented \$(1.9) million and \$0.5 million, respectively. As of June 30, 2015, the redemption value exceeded the accumulated earnings of the Company's redeemable non-controlling (1) interest in Comfort Revolution, LLC. Accordingly, for the six months ended June 30, 2015, the Company recorded a \$0.9 million adjustment, net of tax, to adjust the carrying value of redeemable non-controlling interest to its redemption value. As of June 30, 2016, the accumulated earnings exceeded the redemption value and, accordingly, a redemption value adjustment was not necessary for the six months ended June 30, 2016.

Table of Contents

NET SALES

(in millions)	Six Months Ended June 30,					
	2016		2015		2016	
	Consolidated		North America		International	
Net sales by channel						
Retail channel	\$1,375.1	\$1,379.8	\$1,180.2	\$1,178.1	\$194.9	\$201.7
Other channel	150.3	124.1	68.0	46.3	82.3	77.8
Total net sales	\$1,525.4	\$1,503.9	\$1,248.2	\$1,224.4	\$277.2	\$279.5
Net sales by product						
Bedding	\$1,412.3	\$1,387.1	\$1,190.6	\$1,163.4	\$221.7	\$223.7
Other products	113.1	116.8	57.6	61.0	55.5	55.8
Total net sales	\$1,525.4	\$1,503.9	\$1,248.2	\$1,224.4	\$277.2	\$279.5

Net sales increased 1.4%, and on a constant currency basis increased 3.3%. The increase in net sales was driven by:

North America net sales increased 1.9%. On a constant currency basis, net sales increased approximately 2.5%. Net sales of Bedding products increased \$27.2 million, or 2.3%, primarily due to the success of new product introductions and expanded distribution. Net sales of Other products decreased \$3.4 million, or 5.6% primarily as a result of a decline in net sales through our U.S. joint venture. Canada net sales increased 1.1%, and, on a constant currency basis, increased 8.9%.

International net sales decreased 0.8% due to unfavorable foreign exchange rates. On a constant currency basis, International net sales increased approximately 6.7%, with growth across all major regions. Constant currency growth in International was primarily driven by the success of new product introductions, an increase in direct sales of our Tempur products in Asia-Pacific and an increase in net sales of our Sealy products in Latin America. On a constant currency basis, International Other channel sales increased 17.4%, primarily driven by an increase in net sales through the Internet and our company-owned stores.

GROSS PROFIT

(in millions, except percentages)	Six Months Ended June 30,					
	2016		2015		Margin	
	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Change	
North America	\$481.8	38.6 %	\$430.5	35.2 %	3.4 %	
International	146.1	52.7 %	145.7	52.1 %	0.6 %	
Consolidated gross margin	\$627.9	41.2 %	\$576.2	38.3 %	2.9 %	

Costs associated with net sales are recorded in cost of sales and include the costs of producing, shipping, warehousing, receiving and inspecting goods during the period, as well as depreciation and amortization of long-lived assets used in the manufacturing process. The principal factors impacting gross profit and gross margin for each segment are discussed below in the respective segment discussions.

Gross margin increased 290 basis points. The increase was primarily driven by 210 basis points of operational improvements, including sourcing improvements and decreased commodity costs. In addition, gross margin improved 70 basis points due to pricing actions and 60 basis points due to a decrease in expenses related to the transition of manufacturing and distribution facilities. These factors were partially offset by product mix, as well as unfavorable discounts on new product introductions of 30 basis points, as our product introductions in the first half of 2016 were more significant than in 2015.

North America gross margin increased 340 basis points. The increase was driven primarily by 270 basis points of operational improvements, including sourcing improvements and decreased commodity costs. In addition, gross margin improved 90 basis points due to pricing actions and 70 basis points due to a decrease in expenses related to the transition of manufactu

40

Table of Contents

ring and distribution facilities. These factors were partially offset by unfavorable discounts on new product introductions of 40 basis points, as our product introductions in the first half of 2016 were more significant than in 2015.

International gross margin increased 60 basis points. The increase was driven primarily by channel mix, as we expanded distribution through more profitable direct-to-consumer channels, and operational improvements. These factors were partially offset by an increase in net sales of Sealy products and product introductions.

OPERATING EXPENSES

(in millions)	Six Months Ended June 30,							
	2016	2015	2016	2015	2016	2015	2016	2015
	Consolidated		North America		International		Corporate	
Operating expenses:								
Advertising expenses	\$170.8	\$177.1	\$152.1	\$158.0	\$18.7	\$19.1	\$—	\$—
Other selling and marketing expenses	152.1	145.3	88.5	82.6	60.9	60.9	2.7	1.8
General, administrative and other expenses	143.6	162.8	64.3	71.4	27.6	28.0	51.7	63.4
Total operating expenses	\$466.5	\$485.2	\$304.9	\$312.0	\$107.2	\$108.0	\$54.4	\$65.2

Selling and marketing expenses include advertising and media production associated with the promotion of our brands, other marketing materials such as catalogs, brochures, videos, product samples, direct customer mailings and point of purchase materials, and sales force compensation. We also include in selling and marketing expenses certain new product development costs, including market research and new product testing.

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

Operating expenses decreased \$18.7 million or 3.9% and decreased 170 basis points as a percentage of net sales. In the second half of 2015, we took actions to reduce our overhead expenses. We expect the impact of these headcount reductions and international store closures will reduce our overall operating expenses by approximately \$3.5 million per quarter in 2016 as compared to 2015. The primary drivers of changes in operating expenses by segment are explained below.

North America operating expenses decreased \$7.1 million and decreased 110 basis points as a percentage of net sales. This decrease was primarily driven by a \$7.1 million decrease in general, administrative and other expenses, primarily as a result of a \$2.1 million decrease in research and development costs and reduced operating expenses as a result of headcount reductions in the second half of 2015. Additionally, advertising expenses decreased \$5.9 million, or 3.7%, and decreased 70 basis points as a percentage of net sales. These decreases were partially offset by a \$5.9 million increase in other selling and marketing expenses, primarily due to in-store marketing and media investments associated with new product introductions.

International operating expenses remained relatively flat and increased slightly as a percentage of net sales.

Corporate operating expenses decreased \$10.8 million, or 16.6%. In the first half of 2016, executive management transition and retention compensation decreased \$4.4 million and integration costs decreased \$1.2 million. In addition, in the first half of 2015 we incurred \$6.3 million of additional costs related to our 2015 Annual Meeting which were not incurred in 2016. These decreases were partially offset by an increase in performance related compensation expense.

Research and development expenses for the six months ended June 30, 2016 were \$13.1 million compared to \$15.0 million for the six months ended June 30, 2015, a decrease of \$1.9 million, or 12.7%.

Table of Contents

OPERATING INCOME

(in millions, except percentages)	Six Months Ended June 30,					
	2016		2015		Change	
	Operating Income	Operating Margin	Operating Income	Operating Margin	Operating Margin	Change
North America	\$180.6	14.5 %	\$122.5	10.0 %	4.5 %	
International	50.5	18.2 %	49.0	17.5 %	0.7 %	
	231.1		171.5			
Corporate expenses	(54.2)		(65.1)			
Total operating income	\$176.9	11.6 %	\$106.4	7.1 %	4.5 %	

Operating income increased \$70.5 million and operating margin improved 450 basis points. The increase was driven by:

North America operating income increased \$58.1 million and operating margin improved 450 basis points. The improvement in operating margin was primarily driven by improved gross margin of 340 basis points and an improvement in operating expense leverage of 110 basis points.

International operating income increased \$1.5 million and operating margin improved 70 basis points. The improvement in operating margin was primarily driven by improved gross margin of 60 basis points.

INTEREST EXPENSE, NET

(in millions, except percentages)	Six Months Ended June 30,		
	2016	2015	% Change
Interest expense, net	\$44.5	\$40.9	8.8 %

Interest expense, net, increased \$3.6 million or 8.8%. In connection with the overlapping period between the issuance of the 2026 Senior Notes on May 24, 2016 and redemption of the 2020 Senior Notes on June 23, 2016, we incurred an additional \$2.1 million of interest compared to the first half of 2015. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

LOSS ON EXTINGUISHMENT OF DEBT

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

Table of Contents

INCOME TAX PROVISION

	Six Months Ended June 30,		
(in millions, except percentages)	2016	2015	% Change
Income tax provision	\$26.5	\$18.6	42.5 %
Effective tax rate	31.0 %	28.8 %	

Income tax provision includes income taxes associated with taxes currently payable and deferred taxes, and includes the impact of net operating losses for certain of our foreign operations.

Our income tax provision increased \$7.9 million due primarily to an increase of income before income taxes, particularly that earned in higher taxing jurisdictions, and our effective tax rate increased 220 basis points. For the six months ended June 30, 2016 and 2015, there were no material non-recurring items that impacted the effective tax rate in each period, respectively.

Liquidity and Capital Resources

Liquidity

Our principal sources of funds are cash flows from operations, borrowings made pursuant to our credit facilities and cash and cash equivalents on hand. Principal uses of funds consist of share repurchases, payments of principal and interest on our debt facilities, capital expenditures and working capital needs. As of June 30, 2016, we had working capital of \$180.4 million, including cash and cash equivalents of \$137.9 million, as compared to working capital of \$96.1 million including \$153.9 million in cash and cash equivalents as of December 31, 2015.

The increase in working capital was primarily driven by increases in accounts receivable and inventories, as well as decreases in accounts payable, income taxes payable and the current portion of long-term debt. This was partially offset by a decrease in cash and cash equivalents, as we funded our share repurchase program and other capital requirements, and increases in accrued expenses and other current liabilities. Accounts receivable increases are driven primarily by net sales, in addition to timing of customer collections. Inventory increased primarily due to the build-up associated with new product introductions in 2016. Accounts payable decreases are driven primarily by the timing of payments to vendors. Income taxes payable decreases are driven primarily by the timing of estimated income tax payments. The current portion of long-term debt decreased due to the revised repayment terms negotiated for the term loan facility under our 2016 Credit Agreement. Accrued expenses and other current liabilities increases are driven primarily by the funding of employee compensation and customer incentive programs based on results year-to-date, which were offset by a \$10.0 million contribution to our U.S. defined benefit pension plan during the second quarter of 2016.

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

	Six Months Ended June 30,	
(in millions)	2016	2015
Net cash provided by (used in):		
Operating activities	\$51.9	\$1.1
Investing activities	(24.3)	(26.9)
Financing activities	(40.6)	(5.7)

Cash provided by operating activities increased \$50.8 million in the first half of 2016 as compared to the first half of 2015. The increase in cash provided by operating activities was primarily the result of an increase in net income, excluding the impact of the loss on extinguishment of debt of \$47.2 million. The loss on extinguishment of debt was composed of a non-cash write-off of \$15.8 million in deferred financing costs associated with the 2012 Credit Agreement and 2020 Senior Notes, \$7.8 million of fees paid to lenders associated with the 2016 Credit Agreement and 2026 Senior Notes, and \$23.6 million of a call premium on our 2020 Senior Notes. The lender fees and call premium are presented as uses of cash in financing activities. Cash provided by operating activities also increased due to deferred income taxes, which was offset by increases in cash used in operating assets and liabilities.

Cash used in investing activities decreased \$2.6 million in the first half of 2016 as compared to the first half of 2015. The decrease in cash used in investing activities is due to a decrease in capital expenditures, which is primarily due to the phasing of planned capital projects.

Table of Contents

Cash used in financing activities increased \$34.9 million in the first half of 2016 as compared to the first half of 2015. In the first half of 2016, we repurchased 3.8 million shares of treasury stock for \$222.0 million, including \$6.7 million for shares which settled immediately following June 30, 2016. Our other primary sources and uses of cash for financing activities in the first half of 2016 relate to the repayment of our 2012 Credit Agreement using proceeds from our 2016 Credit Agreement, as well as the repayment of our 2020 Senior Notes using proceeds from our 2026 Senior Notes. In April 2016, we received proceeds of \$524.5 million under our 2016 Credit Agreement and repaid \$521.4 million outstanding under our 2012 Credit Agreement. In May 2016, we received proceeds of \$600.0 million from the issuance of our 2026 Senior Notes and, in June 2016, redeemed the 2020 Senior Notes for \$375.0 million plus a call premium of \$23.6 million. In connection with the 2016 Credit Agreement and 2026 Senior Notes, we paid \$6.2 million in deferred financing costs and \$7.8 million in fees to lenders. Additional borrowings to fund share repurchases and other financing and operating activities during the first half of 2016 were \$310.8 million, offset by repayments of \$334.0 million. Refer to Note 4, "Debt," in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for additional information.

Capital Expenditures

Capital expenditures totaled \$24.3 million and \$34.0 million for the six months ended June 30, 2016 and 2015, respectively. We currently expect our 2016 capital expenditures to be approximately \$70.0 million, which relate to continued strategic investments that we believe will support our future plans.

Debt Service

On April 6, 2016, we entered into our 2016 Credit Agreement, which provides for (i) a \$500.0 million revolving credit facility, (ii) a \$500.0 million term loan facility and (iii) a \$100.0 million delayed draw term loan facility. The Company used \$500.0 million of the proceeds under the term loan facility and approximately \$27.8 million of the proceeds under the revolving credit facility to repay in full the 2012 Credit Agreement and to pay certain transaction fees and expenses incurred in connection with the 2016 Credit Agreement. As of April 6, 2016, the terms of the 2016 Credit Agreement replaced the terms of the 2012 Credit Agreement.

Our total debt increased to \$1,688.1 million as of June 30, 2016 from \$1,479.6 million as of December 31, 2015. After giving effect to letters of credit outstanding of \$18.8 million, total availability under the revolver was \$481.2 million as of June 30, 2016. Refer to Note 4, "Debt", in our Condensed Consolidated Financial Statements included in ITEM 1 under Part I for further discussion of our debt and applicable interest rates.

As of June 30, 2016, our ratio of consolidated funded debt less qualified cash to EBITDA in accordance with the Company's 2016 Credit Agreement was 3.18 times, within the terms of the financial covenants by quarter for the maximum consolidated total net leverage ratio as set forth in the 2016 Credit Agreement, which limits this ratio to 5.00 times. As of June 30, 2016, we were in compliance with all of the financial covenants in our debt agreements.

Our debt agreements contain certain covenants that limit restricted payments, including share repurchases and dividends. The 2016 Credit Agreement and 2023 Senior Notes contain similar limitations which, subject to other conditions, allow unlimited restricted payments at times when the ratio of consolidated funded debt less qualified cash to adjusted EBITDA remains below 3.5 times. In addition, both agreements permit limited restricted payments under certain conditions when the ratio of consolidated funded debt less qualified cash to adjusted EBITDA is above 3.5 times. The limit on restricted payments under the 2016 Credit Agreement and 2023 Senior Notes is in part determined by a basket that grows at 50% of adjusted net income each quarter, reduced by restricted payments that are not otherwise permitted.

For additional information, refer to "Non-GAAP Financial Information" below for the calculation of the ratio of consolidated funded debt less qualified cash to EBITDA in accordance with the Company's 2016 Credit Agreement. Both consolidated funded debt and EBITDA in accordance with the Company's 2016 Credit Agreement are terms that are not recognized under U.S. GAAP and do not purport to be alternatives to net income as a measure of operating performance or total debt.

Non-GAAP Financial Information

We provide information regarding adjusted net income, adjusted EPS, adjusted gross profit, adjusted gross margin, adjusted operating income (expense), adjusted operating margin, EBITDA, adjusted EBITDA, consolidated funded debt and consolidated funded debt less qualified cash, which are not recognized terms under U.S. GAAP and do not purport to be alternatives to net income and earnings per share as a measure of operating performance or total debt. We believe these non-GAAP measures provide investors with performance measures that better reflect our underlying operations and trends, including trends in changes

Table of Contents

in margin and operating expenses, providing a perspective not immediately apparent from net income and operating income. The adjustments management makes to derive the non-GAAP measures include adjustments to exclude items that may cause short-term fluctuations in the nearest GAAP measure, but which management does not consider to be the fundamental attributes or primary drivers of its business, including costs associated with its 2013 acquisition of Sealy Corporation and its subsidiaries ("Sealy Acquisition") and the exclusion of other costs associated with the 2015 Annual Meeting (including executive management transition and retention compensation), legal settlements, costs associated with the completion of the 2016 Credit Agreement and 2026 Senior Notes offering in the second quarter of 2016 and other costs.

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

Second Quarter 2016 Key Highlights

(in millions, except percentages and per common share amounts)	Three Months Ended		% Change	% Change Constant Currency ⁽¹⁾	
	June 30, 2016	June 30, 2015			
Net sales	\$804.4	\$764.4	5.2 %	6.6 %	%
Net income	21.3	21.2	0.5 %	13.7 %	%
EPS	0.35	0.34	2.9 %	17.6 %	%
Adjusted EBITDA ⁽¹⁾	124.7	90.3	38.1 %	42.7 %	%
Adjusted EPS ⁽¹⁾	\$0.92	\$0.53	73.6 %	83.0 %	%

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

Adjusted Net Income and Adjusted EPS.

A reconciliation of net income to adjusted net income and a calculation of adjusted EPS is provided below. We believe that the use of these non-GAAP financial measures provides investors with additional useful information with respect to the impact of various adjustments as described in the footnotes below. The following table sets forth the reconciliation of our reported net income to the calculation of adjusted net income for the three months ended June 30, 2016 and 2015, respectively.

(in millions, except per share amounts)	Three Months Ended	
	June 30, 2016	June 30, 2015
GAAP net income	\$21.3	\$21.2
Loss on extinguishment of debt ⁽¹⁾	47.2	—
Interest expense ⁽²⁾	2.1	—
Integration costs ⁽³⁾	1.0	6.7

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Executive management transition and retention compensation ⁽⁴⁾	—	7.5
2015 Annual Meeting costs ⁽⁵⁾	—	4.2
Tax adjustment ⁽⁶⁾	(15.9)	(6.3)
Adjusted net income	\$55.7	\$ 33.3
Adjusted earnings per common share, diluted	\$0.92	\$ 0.53
Diluted shares outstanding	60.8	62.4

45

Table of Contents

- (1) Loss on extinguishment of debt represents costs associated with the completion of the 2016 Credit Facility and the offering of Senior Notes due 2026 in the second quarter of 2016.
- (2) Interest expense represents incremental interest incurred upon the Senior Notes due 2026 sold in the second quarter of 2016 and the Senior Notes due 2020, which were repaid with a portion of the proceeds of the Senior Notes due 2026.
- (3) Integration costs represents costs, including legal fees, professional fees, compensation costs and other charges related to the transition of manufacturing facilities, and other costs related to the continued alignment of the North America business segment related to the Sealy Acquisition.
- (4) Executive management transition and retention compensation represents certain costs associated with the transition of certain of the Company's executive officers following the 2015 Annual Meeting.
- (5) 2015 Annual Meeting costs represent additional costs related to the Company's 2015 Annual Meeting and related issues.
- (6) Adjusted income tax provision represents adjustments associated with the aforementioned items and other discrete income tax events.

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

A reconciliation of gross profit and gross margin to adjusted gross profit and gross margin, respectively, and operating income (expense) and operating margin to adjusted operating income (expense) and operating margin, respectively, is provided below. We believe that the use of these non-GAAP financial measures provides investors with additional useful information with respect to the impact of various adjustments as described in the footnotes below. The following table sets forth the reconciliation of the Company's reported GAAP gross profit and operating income (expense) to the calculation of adjusted gross profit and operating income (expense) for the three months ended June 30, 2016.

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

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

(2) Adjustments for Corporate represent executive management transition and retention costs and integration costs which include professional fees and other charges to align the business related to the Sealy Acquisition.

The following table sets forth the reconciliation of the Company's reported GAAP gross profit and operating income (expense) to the calculation of adjusted gross profit and operating income (expense) for the three months ended June 30, 2015.

(in millions, except percentages)	Three Months Ended June 30, 2015						
	Consolidated	Margin	Margin	International	Margin	Corporate	

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			North America (1)		(2)		(3)
Net sales	\$764.4		\$ 630.3		\$ 134.1		\$ —
Gross profit	\$297.5	38.9 %	\$ 227.4	36.1 %	\$ 70.1	52.3 %	\$ —
Adjustments	3.5		3.4		0.1		—
Adjusted gross profit	\$301.0	39.4 %	\$ 230.8	36.6 %	\$ 70.2	52.3 %	\$ —
Operating income (expense)	\$52.0	6.8 %	\$ 64.6	10.2 %	\$ 23.7	17.7 %	\$ (36.3)
Adjustments	18.4		5.7		0.6		12.1
Adjusted operating income (expense)	\$70.4	9.2 %	\$ 70.3	11.2 %	\$ 24.3	18.1 %	\$ (24.2)

46

Table of Contents

- Adjustments for the North America segment represent executive management retention costs, integration costs (which include compensation costs, professional fees and other charges related to the transition of manufacturing facilities) and other costs to support the continued alignment of the North America segment related to the Sealy Acquisition.
- (1) Adjustments for the International segment represent executive management retention costs and integration costs incurred in connection with the introduction of Sealy products in certain international markets.
- (2) Adjustments for Corporate represent executive management transition and retention costs and integration costs which include professional fees and other charges to align the business related to the Sealy Acquisition.
- (3)

EBITDA, Adjusted EBITDA and Consolidated funded debt less qualified cash.

The following reconciliations are provided below:

Net income to EBITDA and adjusted EBITDA

Total debt to consolidated funded debt less qualified cash

Ratio of consolidated funded debt less qualified cash to adjusted EBITDA

We believe that presenting these non-GAAP measures provides investors with useful information with respect to our operating performance and comparisons from period to period, as well as general information about our progress in reducing our leverage. The following table sets forth the reconciliation of net income to the calculation of adjusted EBITDA for the three months ended June 30, 2016 and 2015.

(in millions)	Three Months Ended	
	June 30, 2016	June 30, 2015
GAAP net income	\$21.3	\$ 21.2
Loss on extinguishment of debt	47.2	—
Interest expense	23.1	20.5
Income taxes	9.2	8.3
Depreciation and amortization	22.9	