TEMPUR PEDIC INTERNATIONAL INC
Form 10-Q
May 10, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

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

For the transition period from

to

Commission file number 001-31922

TEMPUR-PEDIC 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 x No o

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

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
	(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 x

The number of shares outstanding of the registrant's common stock as of May 9, 2013 was 60,348,983 shares.

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Special Note Regarding Forward-Looking Statements

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

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. There are important factors, many of which are beyond the Company’s control, that could cause our actual results to differ materially from those expressed as forward-looking statements in this report, including the risk factors discussed under the heading “Risk Factors” under ITEM IA of Part II of this report and under the heading “Risk Factors” under ITEM 1A of Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2012. There may be other factors that may cause our actual results to differ materially from the forward-looking statements.

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

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

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In millions, except per common share amounts)
(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net sales	$ 390.1	$ 384.4
Cost of sales	201.7	178.4
Gross profit	188.4	206.0
Selling and marketing expenses	86.4	83.3
General, administrative and other expenses	58.7	36.6
Royalty income, net of royalty expense	(1.0)	—
Operating income	44.3	86.1
Other expense, net:		
Interest expense, net	(27.9)	(4.1)
Other expense, net	(1.5)	(0.5)
Total other expense	(29.4)	(4.6)
Income before income taxes	14.9	81.5
Income tax provision	(2.6)	(25.3)
Equity in earnings of unconsolidated affiliates	0.2	—
Net income	$ 12.5	$ 56.2
Earnings per common share:		
Basic	$ 0.21	$ 0.88
Diluted	$ 0.20	$ 0.86
Weighted average common shares outstanding:		
Basic	60.0	63.9
Diluted	61.2	65.7

See accompanying Notes to Condensed Consolidated Financial Statements.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)
(Unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net income	$12.5	$56.2
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	(11.1)	5.6
Net change in unrecognized loss on interest rate swap	0.4	(0.3)
Other comprehensive (loss) income, net of tax	(10.7)	5.3
Comprehensive income	$1.8	$61.5

See accompanying Notes to Condensed Consolidated Financial Statements

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions)

	March 31, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$91.5	$ 179.3
Accounts receivable, net	325.0	129.8
Inventories	170.9	93.0
Escrow receivable	92.7	375.0
Prepaid expenses and other current assets	46.9	41.4
Deferred income taxes	33.3	2.6
Total Current Assets	760.3	821.1
Property, plant and equipment, net	433.5	186.0
Goodwill	764.9	216.1
Other intangible assets, net	770.4	63.1
Deferred income taxes	9.9	10.4
Other non-current assets	87.9	16.3
Total Assets	$2,826.9	$ 1,313.0
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$157.5	$ 85.8
Accrued expenses and other current liabilities	197.4	81.4
Deferred income taxes	0.4	26.5
Income taxes payable	21.4	15.5
Current portion of long-term debt	36.2	—
Total Current Liabilities	412.9	209.2
Long-term debt	1,961.7	1,025.0
Deferred income taxes	331.1	31.4
Other non-current liabilities	93.8	25.1
Total Liabilities	2,799.5	1,290.7
Commitments and contingencies—see Note 12		
Total Stockholders' Equity	27.4	22.3
Total Liabilities and Stockholders' Equity	$2,826.9	$ 1,313.0

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$12.5	$56.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11.2	8.7
Amortization of stock-based compensation	3.5	4.4
Amortization of deferred financing costs	0.4	0.4
Write-off of deferred financing costs	4.7	—
Bad debt expense	0.5	—
Deferred income taxes	(41.5)	(5.6)
Equity in earnings of unconsolidated affiliates	(0.2)	—
Foreign currency adjustments and other	(0.1)	1.1
Changes in operating assets and liabilities	14.2	(20.6)
Net cash provided by operating activities	5.2	44.6
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of business, net of cash acquired	(1,265.5)	—
Purchases of property, plant and equipment	(5.6)	(6.6)
Other	0.1	—
Net cash used in investing activities	(1,271.0)	(6.6)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from 2012 Credit Agreement	1,525.0	—
Repayments of 2012 Credit Agreement	(24.1)	—
Proceeds from issuance of Senior Notes	375.0	—
Proceeds from 2011 Credit Facility	46.5	31.5
Repayments of 2011 Credit Facility	(696.5)	(51.5)
Proceeds from issuance of common stock	4.2	7.3
Excess tax benefit from stock based compensation	2.5	8.7
Treasury shares repurchased	—	(14.9)
Payments of deferred financing costs	(51.5)	—
Other	(0.3)	(0.3)
Net cash provided by (used in) financing activities	1,180.8	(19.2)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(2.8)	3.8
(Decrease) Increase in cash and cash equivalents	(87.8)	22.6
CASH AND CASH EQUIVALENTS, beginning of period	179.3	111.4
CASH AND CASH EQUIVALENTS, end of period	$91.5	$134.0
Supplemental cash flow information:		
Cash paid during the period for:		

Interest	$15.1	$3.7
Income taxes, net of refunds	$7.9	$15.0

See accompanying Notes to Condensed Consolidated Financial Statements.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

(1) Summary of Significant Accounting Policies

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

On March 18, 2013, the Company completed the acquisition of Sealy Corporation (“Sealy”), which manufactures and markets a broad range of mattresses and foundations under the Sealy®, Sealy Posturepedic®, Sealy EmbodyTM, OptimumTM by Sealy Posturepedic®, Stearns & Foster®, and Bassett® brands. The Company’s acquisition of Sealy is more fully described in Note 2, “Business Combination”. The results of operations for Sealy Corporation and its historical subsidiaries are reported within the Company’s Sealy reportable segment and includes results from March 18, 2013 to March 31, 2013. In connection with the acquisition, the Company borrowed approximately $1,900.0 million in aggregate principal to fund the purchase price and to repay all outstanding borrowings under the 2011 Credit Facility, which is described in Note 4, “Long-Term Debt”.

As a result of the acquisition, the Company’s Condensed Consolidated Financial Statements include the results of Comfort Revolution International, LLC (“Comfort Revolution”), a 45.0% owned joint venture with Comfort Revolution, LLC. Comfort Revolution constitutes a variable interest entity for which the Company is considered to be the primary beneficiary due to the Company's disproportionate share of the economic risk associated with its equity contribution and debt financing and other factors that were considered in the related-party analysis surrounding the identification of the primary beneficiary. Comfort Revolution is not material to the Company’s Condensed Consolidated Financial Statements.

The Company develops, manufactures, and markets bedding products, which include mattresses, foundations and adjustable bases, and other products, which include pillows and other accessories. The Company derives income from royalties by licensing Sealy® brands, technology and trademarks to other manufacturers. Additionally, the Company participates in joint ventures in the Asia Pacific market. The Company sells its products through three sales channels: Retail, Direct and Other.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States (“U.S. GAAP”) for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Company and related footnotes for the year ended December 31, 2012, included in the Company’s Annual Report on Form 10-K and Form 8-K filed April 1, 2013.

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

(b) Reclassifications. The Company reclassified certain accrued expenses and other current liabilities to other non-current liabilities to conform to the 2013 presentation of Condensed Consolidated Financial Statements. This change does not materially impact previously reported subtotals within the Condensed Consolidated Financial Statements for any previous period presented.

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

(in millions)	March 31, 2013	December 31, 2012
Finished goods	$112.4	$ 68.5
Work-in-process	10.0	7.9
Raw materials and supplies	48.5	16.6
	$170.9	$ 93.0

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

(d) 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. The level of sales returns differs by channel with the Direct channel typically experiencing the highest rate of return. Estimated future obligations related to these products are provided by a reduction of sales in the period in which the revenue is recognized. Accrued sales returns are included in accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

The Company had the following activity for sales returns from December 31, 2012 to March 31, 2013:

(in millions)		
Balance as of December 31, 2012	$	5.1
Amounts accrued		14.9
Liabilities assumed as result of acquisition		19.9
Returns charged to accrual		(14.3)
Balance as of March 31, 2013	$	25.6

(e) Warranties. The Company provides a 10-25 year warranty for mattresses and 2-3 year warranty on pillows. Estimated future obligations related to these products are charged to cost of sales in the period in which the related revenue is recognized. Estimates of warranty expenses are based primarily on historical claim experience and product testing.

The Company had the following activity for warranties from December 31, 2012 to March 31, 2013:

(in millions)		
Balance as of December 31, 2012	$	4.8
Amounts accrued		2.0
Liabilities assumed as a result of acquisition		16.9
Warranties charged to accrual		(1.9)
Balance as of March 31, 2013	$	21.8

As of March 31, 2013 and December 31, 2012, $11.7 million and $1.9 million are included as a component of accrued expenses and other current liabilities and $10.1 million and $2.9 million are included in other non-current liabilities on the Company’s accompanying Condensed Consolidated Balance Sheets, respectively.

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

The allowance for doubtful accounts is the Company’s best estimate of the amount of probable credit losses in the Company’s existing accounts receivable. The Company regularly reviews the adequacy of its allowance for doubtful accounts. The Company determines the allowance based on historical write-off experience and current economic conditions. It also considers factors such as customer credit, past transaction history with the customer and changes in customer payment terms when determining whether the collection of a receivable is reasonably assured. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts included in accounts receivable, net in the accompanying Condensed Consolidated Balance Sheets was $22.5 million and $8.2 million as of March 31, 2013 and December 31, 2012, respectively.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

(g) Research and Development Expenses. Research and development expenses for new products are expensed as they are incurred and included in general, administrative and other expenses in the accompanying Condensed Consolidated Statements of Income. Research and development costs charged to expense were $4.8 million and $3.4 million for the three months ended March 31, 2013 and 2012, respectively.

(h) Royalty Income and Expense. The Company recognizes royalty income based on sales of Sealy® and Stearns & Foster® branded product by various licensees. The Company also pays royalties to other entities for the use of their names on product produced by the Company. These amounts are not material for the three months ended March 31, 2013.

(j) Environmental Obligations. Accruals for environmental remediation are recognized when it is probable a liability has been incurred and the amount of that liability can be reasonably estimated. Such costs are charged to expense if they relate to the remediation of conditions caused by past operations or are not expected to mitigate or prevent contamination from future operations. Liabilities are recorded at estimated cost values based on experience, assessments and current technology, without regard to any third-party recoveries and are regularly adjusted as environmental assessments and remediation efforts continue.

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

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

(2) Business Combination

On March 18, 2013, the Company completed the acquisition of Sealy ("Sealy Acquisition"). Pursuant to the merger agreement, each share of common stock of Sealy issued and outstanding immediately prior to the effective time of the acquisition was cancelled and (other than shares held by Sealy or Tempur-Pedic or their subsidiaries or Sealy stockholders who properly exercised their appraisal rights) converted into the right to receive $2.20 in cash. The total purchase price was $1,265.5 million, which was funded using available cash and financing consisting of our 2012 Credit Agreement and Senior Notes (see Note 4, "Long-Term Debt" for the definition of these terms and further discussion). The purchase price of Sealy consisted of the following items:

(in millions)			
Cash consideration for stock	$	231.2	(1)
Cash consideration for share-based awards		14.2	(2)
Cash consideration for 8.0% Sealy Notes		442.1	(3)
Cash consideration for repayment of Sealy Senior Notes		260.6	(4)
Cash consideration for repayment of Sealy 2014 Notes		276.9	(5)
Total consideration		1,225.0	
Paid to escrow – 8.0% Sealy Notes		92.7	(6)
Cash acquired		(52.2)	(7)
Net consideration transferred	$	1,265.5	

(1) The cash consideration for outstanding shares of Sealy common stock is the product of the agreed-upon cash per share price of $2.20 and total Sealy shares of 105.1 million.

(2) The cash consideration for share-based awards is the product of the agreed-upon cash per share price of $2.20 and the total number of restricted stock units and deferred stock units outstanding and the "in the money" stock options net of the weighted average exercise price.

(3) The cash consideration for Sealy's 8.0% Senior Secured Third Lien Convertible Notes due 2016 ("8.0% Sealy Notes") is the result of applying the adjusted equity conversion rate to the 8.0% Sealy Notes tendered for conversion and multiplying the result by the agreed-upon cash per share price of $2.20. The 8.0% Sealy Notes that were converted into the right to receive the same merger consideration that would have been payable to a holder of 201.0 million shares of Sealy common stock, subject to adjustment in accordance with the terms of the supplemental indenture governing the 8.0% Sealy Notes.

(4) The cash consideration for Sealy's 10.875% Senior Notes due 2016 ("Sealy Senior Notes") reflects the repayment of the outstanding obligation.

(5) The cash consideration for Sealy's 8.25% Senior Subordinated Notes due 2014 ("Senior Subordinated Notes") reflects the repayment of the outstanding obligation.

(6) Pursuant to the merger agreement, the Company deposited with a paying agent an amount in cash sufficient to make payment to all holders of the 8.0% Sealy Notes who converted their notes during a make-whole period. Of this amount deposited, approximately $92.7 million will be transferred back to the Company after the expiration of a deposit period specified in the related paying agency agreement. The 8.0% Sealy Notes will continue to be secured obligations of Sealy and certain of its subsidiaries until maturity.

(7) Represents the Sealy cash balance acquired at acquisition.

The Company incurred $11.8 million of direct transaction costs, which are recorded in general, administrative and other expenses for the three months ended March 31, 2013. In addition, the Company incurred $19.9 million of incremental interest expense for the three months ended March 31, 2013, which includes interest and other fees on the Senior Notes and the 2012 Credit Agreement for the period prior to March 18, 2013, commitment fees associated with financing for the closing of the acquisition, and the write off of deferred financing costs associated with the 2011 Credit Facility.

Sealy, headquartered in Trinity, North Carolina, owns one of the largest portfolios of bedding brands in the world, and manufactures and markets a complete line of bedding products under the Sealy®, Sealy Posturepedic®, Sealy EmbodyTM, OptimumTM by Sealy Posturepedic®, Stearns & Foster®, and Bassett® brands. The results of operations of Sealy and Sealy's historical subsidiaries are reported within the Company's Sealy reportable segment. The combination brings together two highly complementary companies with iconic brands and significant opportunities for global innovation and growth. Tempur-Pedic and Sealy together will have products for almost every consumer preference and price point, distribution through all key channels, in-house expertise on most key bedding technologies, and a world-class research and development team. In addition, the combined operations have a global footprint that includes over 80 countries. The Company believes the shared know-how and improved efficiencies of the combined company will result in tremendous value for its consumers, retailers and stockholders.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

The Company accounted for the Sealy Acquisition using the acquisition method. The preliminary allocation of the purchase price is based on estimates of the fair value of assets acquired and liabilities assumed as of March 18, 2013. The Company is continuing to obtain information to complete its valuation of intangible assets, as well as to determine the acquired assets and liabilities, including tax assets, liabilities and other attributes. The components of the preliminary purchase price allocation are as follows:

(in millions)	
Accounts receivable	$186.4
Inventory	75.1
Prepaid expenses and other current assets	42.3
Accounts payable	(77.7)
Accrued expenses	(126.4)
Property, plant and equipment	252.3
Other assets	36.7
Identifiable intangible assets:	
Indefinite-lived trade names	522.8
Contractual retailer/distributer relationships	91.1
Developed technology, including patents	88.8
Customer databases	3.9
Definite-lived trade names	2.3
Deferred income taxes, net	(281.6)
Other liabilities	(99.8)
Goodwill	549.3
Net consideration transferred	$1,265.5

The preliminary fair value of the intangible assets has been estimated using the income approach through a discounted cash flow analysis (except as noted below with respect to the trade names) with the cash flow projections discounted using rates ranging from 11.0% to 12.0%. The cash flows are based on estimates used to price the Sealy Acquisition, and the discount rates applied were benchmarked with reference to the implied rate of return from the Company's pricing model and the weighted average cost of capital.

The indefinite-lived trade names represent Sealy brand names as marketed through Sealy®, Sealy Posturepedic®, Stearns & Foster®, and Bassett® brands. The Company applied the income approach through an excess earnings analysis to fair value the trade name assets.

The contractual retailer/distributor relationships pertain to Sealy's distribution network with their retailers, which is governed by contract. The Company used the income approach through an excess earnings analysis to determine the preliminary fair value of this asset.

The developed technology assets are comprised of know-how, patents and technologies embedded in Sealy's products and processes and relate to currently manufactured and marketed products. The Company applied the income approach through a relief-from-royalty analysis to fair value this asset.

The Company will amortize the identifiable intangible assets on a straight-line basis over the weighted average lives ranging from 3 to 15 years.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

The Company estimated the preliminary fair value of the acquired property, plant and equipment using a combination of the cost and market approaches, depending on the component. The preliminary fair value of property, plant and equipment consisted of real property of $108.9 million and personal property of $143.4 million.

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

Sealy's net sales and pre-tax loss for the period from the acquisition date to March 31, 2013 were $46.7 million and $3.6 million, respectively. The following unaudited pro forma information presents the combined financial results for the Company and Sealy as if the Sealy Acquisition had been completed at the beginning of the Company's prior fiscal year, January 1, 2012. Sealy's pro forma information is provided for the quarterly periods December 3, 2012 through March 3, 2013 and November 28, 2011 through February 26, 2012, respectively.

(in millions, except earnings per common share)	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net sales	$ 683.0	$ 696.7
Net income	$ 15.6	$ 29.0
Earnings from continuing operations per common share - Diluted	$ 0.25	$ 0.44

The information above does not include the pro forma adjustments that would be required under Regulation S-X for pro forma financial information, and does not reflect future events that may occur after March 31, 2013 or any operating efficiencies or inefficiencies that may result from the Sealy Acquisition and related financing. Therefore, the information is not necessarily indicative of results that would have been achieved had the businesses been combined during the periods presented or the results that the Company will experience going forward.

(3) Goodwill and Other intangible assets

During the three months ending March 31, 2013, the Company's goodwill increased by approximately $549.3 million related to the Sealy Acquisition. This amount is subject to change based upon the finalization of the allocation of the consideration transferred to the assets acquired and liabilities assumed from Sealy Corporation.

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

(in millions)	Total	Tempur North America	Tempur International	Sealy
Balance as of December 31, 2012	$216.1	$ 108.9	$ 107.2	$—
Foreign currency translation adjustments	(0.5)	(0.4)	(0.1)	—
Goodwill resulting from acquisitions	549.3	—	—	549.3
Balance as of March 31, 2013	$764.9	$ 108.5	$ 107.1	$549.3

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

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

(in millions)

		March 31, 2013			December 31, 2012		
	Useful Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Unamortized indefinite life intangible assets:							
Trademarks		$577.8	$ —	$577.8	$55.0	$ —	$55.0
Amortized intangible assets:							
Contractual distributor relationships	15	$91.1	$ 0.2	$90.9	$—	$ —	$—
Technology	10	90.5	16.0	74.5	16.0	16.0	—
Patents & other Trademarks	5-20	29.6	10.1	19.5	12.9	9.9	3.0
Customer database	5	8.7	4.8	3.9	4.9	4.9	—
Foam formula	10	3.7	3.7	—	3.7	3.7	—
Reacquired rights	3	5.6	5.6	—	5.8	5.3	0.5
Customer relationships	5	6.5	2.7	3.8	6.7	2.1	4.6
Total		$813.5	$ 43.1	$770.4	$105.0	$ 41.9	$63.1

Amortization expense relating to intangible assets for the Company was $1.6 million and $1.4 million for the three months ended March 31, 2013 and 2012, respectively. No impairments of goodwill or other intangible assets have adjusted the gross carrying amount of these assets in any historical period.

(4) Long-term Debt

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

(in millions)	March 31, 2013	December 31, 2012
Long term debt:		
$375.0 million Senior Notes, interest at 6.875%, due December 15, 2020	$375.0	$ 375.0
Revolving credit facility, interest at Base Rate plus applicable margin or LIBOR plus applicable margin, 3.0% as of March 31, 2013, commitment through and due March 18, 2018	90.0	—
Term A Facility, interest at Base Rate plus applicable margin or LIBOR plus applicable margin, 3.0% as of March 31, 2013, commitment through and due March 18, 2018	543.1	—
	867.8	—

Term B Facility, interest at Base Rate plus applicable margin or LIBOR plus applicable margin, 3.0% as of March 31, 2013, commitment through and due March 18, 2020		
8.0% Sealy Notes, due July 15, 2016	96.2	—
Capital lease obligations	25.8	—
2011 Domestic long-term revolving credit facility payable to lenders, interest at Base Rate or LIBOR plus applicable margin (2.05% as of December 31, 2012), commitment through and due June 28, 2016	—	650.0
	$1,997.9	$ 1,025.0
Less current portion	(36.2)	—
	$1,961.7	$ 1,025.0

Senior Notes

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

Tempur-Pedic International has the option to redeem all or a portion of the Senior Notes at any time on or after December 15, 2016. The initial redemption price is 103.438% of the principal amount, plus accrued and unpaid interest, if any. The redemption price will decline each year after 2016 until it becomes 100.0% of the principal amount beginning on December 15, 2018. In addition, Tempur-Pedic International has the option at any time prior to December 15, 2016 to redeem some or all of the Senior Notes at 100.0% of the original principal amount plus a "make-whole" premium and accrued and unpaid interest, if any. Tempur-Pedic International may also redeem up to 35.0% of the Senior Notes prior to December 15, 2015, under certain circumstances with the net cash proceeds from certain equity offerings, at 106.875% of the principal amount plus accrued and unpaid interest, if any. Tempur-Pedic International may make such redemptions only if, after any such redemption, at least 65.0% of the original aggregate principal amount of the Senior Notes issued remains outstanding.

The Indenture restricts the ability of Tempur-Pedic 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-Pedic 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.

Also in conjunction with the issuance and sale of the Senior Notes, Tempur-Pedic International and the Guarantors have agreed through a Registration Rights Agreement to exchange the Senior Notes for a new issue of substantially identical senior notes registered under the Securities Act. Tempur-Pedic International and the Guarantors are required to pay additional interest if the Senior Notes are not registered within the time periods specified within the Registration Rights Agreement.

2012 Credit Agreement

On December 12, 2012, Tempur-Pedic International and certain subsidiaries of Tempur-Pedic International as borrowers and guarantors, entered into a credit agreement (the "2012 Credit Agreement") with a syndicate of banks. The 2012 Credit Agreement provides 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"). The Revolver includes a sublimit for letters of credit and swingline loans, subject to certain conditions and limits. The Revolver and the Term A Facility will mature on March 18, 2018 and the Term B Facility will mature on March 18, 2020. The Revolver, the Term A Facility and the Term B Facility closed and funded in connection with the Sealy Acquisition and March 18, 2013.

Borrowings under the 2012 Credit Agreement will generally bear interest, at the election of Tempur-Pedic International and the other borrowers, at either (i) London Inter-Bank Offering Rate ("LIBOR") plus the applicable margin or (ii) Base Rate plus the applicable margin. For the Revolver and the Term A Facility, (a) the initial applicable margin for LIBOR advances is 3.00% per annum and the initial applicable margin for Base Rate advances is 2.00% per annum, and (b) thereafter following the delivery of financial statements for the first full fiscal quarter after closing, such applicable margins will be determined by a pricing grid based on the consolidated total net leverage ratio of the Company. The Term B Facility is subject to a LIBOR floor of 1.0%. The applicable margin is 4.00% per annum for LIBOR advances and 3.00% per annum for Base Rate advances.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

Obligations under the 2012 Credit Agreement are guaranteed by Tempur-Pedic International's existing and future direct and indirect wholly-owned domestic subsidiaries, subject to certain exceptions; and the 2012 Credit Agreement is secured by a security interest in substantially all Tempur-Pedic International's and the other borrowers' assets and the assets of each subsidiary guarantor, whether owned as of the closing or thereafter acquired, including a pledge of 100.0% of the equity 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 2012 Credit Agreement requires compliance with certain financial covenants providing for maintenance of a minimum consolidated interest coverage ratio and maintenance of a maximum consolidated total net leverage ratio. The consolidated total net leverage ratio is calculated using consolidated funded debt less qualified cash. Consolidated funded debt includes long-term 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 exclude 100.0% of the domestic qualified cash which includes the cash held in escrow related to the outstanding 8.0% Sealy Notes not converted as of March 31, 2013, and 60.0% of qualified foreign cash, the aggregate of which cannot exceed $150.0 million at the end of the reporting period. As of March 31, 2013, domestic qualified cash including escrow receivable was $121.5 million and foreign qualified cash was $37.6 million.

The 2012 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 2012 Credit Agreement also contains certain customary affirmative covenants and events of default, including upon a change of control.

Tempur-Pedic International is required to pay a commitment fee on the unused portion of the Revolver, which initially is 0.50% per annum and which steps down to 0.375% per annum if the consolidated total net leverage ratio is less than or equal to 3.50:1.00. Such unused commitment fee will be payable quarterly in arrears and on the date of termination or expiration of the commitments under the Revolver. Tempur-Pedic International and the other borrowers will also pay customary letter of credit issuance and other fees under the 2012 Credit Agreement.

The Company is in compliance with all applicable covenants at March 31, 2013.

8.0% Sealy Notes

In conjunction with the Sealy Acquisition, Sealy's obligations under its 8.0% Senior Secured Third Lien Convertible Notes due 2016 (the "8.0% Sealy Notes") were amended. As a result of the Sealy Acquisition, the 8.0% Sealy Notes became convertible solely into cash, in an amount that declined slightly every day during the Make-Whole Period (as defined under the Supplemental Indenture governing the 8.0% Sealy Notes) that followed the Sealy Acquisition, and then became fixed thereafter. The Make-Whole Period effectively expired on April 12, 2013. As of April 12, 2013, approximately 83.0% of all the 8.0% Sealy Notes outstanding prior to the Sealy Acquisition were converted into cash and paid to the holders. Holders of the 8.0% Sealy Notes who converted on March 19, 2013 received approximately $2,325.43 per $1,000 Accreted Principal Amount of the 8.0% Sealy Notes being converted. The holders of the 8.0% Sealy Notes who convert after April 12, 2013 will receive $2,200 per $1,000 Accreted Principal Amount of the 8.0% Sealy Notes being converted. The Company calculated the preliminary fair value of the remaining 8.0% Sealy Notes as part of its preliminary purchase price allocation by first calculating the future payout of the remaining 17.0% aggregate principal amount of the 8.0% Sealy Notes still outstanding and the cumulative semi-annual interest payments at the July 15, 2016 maturity, and then calculated the present value using a market discount rate, which resulted in a fair value of $96.2 million at March 31, 2013. The resulting discount will be accreted to interest expense over the life of the 8.0% Sealy Notes using the effective interest method.

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

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

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

Capital Leases

As a result of the Sealy Acquisition, the Company is party to three separate capital leases and has recorded the preliminary fair value of the obligation on its condensed balance sheet as of March 31, 2013. The approximate remaining life of the leases is 10 years.

2011 Credit Facility

In conjunction with the closing of the Sealy Acquisition, the Company repaid all outstanding borrowings on the 2011 Credit Facility on March 18, 2013 and terminated this facility. The 2011 Credit Facility consisted of domestic and foreign credit facilities (the “2011 Revolvers”) that provided for the incurrence of indebtedness up to an aggregate principal amount of $770.0 million. The domestic credit facility was a five-year, $745.0 million revolving credit facility.

Deferred Financing Costs

As a result of the Company’s issuance of the Senior Notes and in conjunction with entering into the 2012 Credit Agreement, $51.5 million of deferred financing costs were capitalized and will be amortized as interest expense over the respective debt instrument period, ranging from five to eight years, using the effective interest method.

In conjunction with the repayment of all outstanding borrowings on the 2011 Credit Facility, the Company wrote off the associated $4.7 million of deferred financing costs.

Deferred financing costs are recorded within other non-current assets in the accompanying Condensed Consolidated Balance Sheets and interest expense, net in the accompanying Condensed Consolidated Statements of Income.

Interest Rate Swap

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

(5) Unconsolidated Affiliate Companies

The Company has ownership interests in a group of joint ventures to develop markets for Sealy® branded products in the Asia-Pacific region. The Company’s ownership interest in these joint ventures is 50.0% and they are accounted for under the equity method. The Company’s share of earnings is recorded in equity in earnings of unconsolidated affiliates in the accompanying Condensed Consolidated Statements of Income.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

Summarized statements of operations for these joint ventures from March 18, 2013, the date of the Sealy Acquisition, until March 31, 2013 are set forth below:

(in millions)

Revenues	$2.8
Gross profit	1.9
Income from operations	0.4
Net income	0.3

(6) Fair Value Measurements

The classification of fair value measurements within the established three-level hierarchy is based upon the lowest level of input that is significant to the measurement. There were no transfers between levels for the three months ended March 31, 2013. At March 31, 2013, the Company had an interest rate swap recorded at fair value. The fair value of the interest rate swap is calculated using standard industry models based on observable forward yield curves. The fair values of all derivative instruments are adjusted for credit risk and restrictions and other terms specific to the contracts. The Company also utilizes foreign currency forward contracts to manage the risk associated with exposures to foreign currency risk related to intercompany debt and associated interest payments. In addition, the Company utilizes option contracts and diesel swap contracts to manage the risk associated with fluctuations in the prices of diesel fuel used in the transportation of its finished products to customers. The foreign currency forward contracts and option contracts and diesel swap contracts are not material to the accompanying Condensed Consolidated Financial Statements.

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

(in millions)		Fair Value Measurements at March 31, 2013 Using:		
	March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swap	$3.7	$—	$3.7	$—

(in millions)		Fair Value Measurements at December 31, 2012 Using:		
	December 31, 2012	Quoted Prices in Active Markets	Significant Other Observable	Significant Unobservable Inputs (Level 3)

		for Identical Assets (Level 1)	Inputs (Level 2)	
Liabilities:				
Interest rate swap	$ 4.3	$ —	$ 4.3	$ —

The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term maturity of those instruments. Borrowings under the 2012 Credit Agreement are at variable interest rates and accordingly their carrying amounts approximate fair value. The fair value of the Senior Notes were approximately $398.9 million at March 31, 2013.

(7) Derivative Financial Instruments

In the normal course of business, the Company is exposed to certain risks related to fluctuations in interest rates. The Company uses interest rate swaps to manage risks from these market fluctuations. The financial instruments used by the Company are straight-forward, non-leveraged instruments. The counterparties to these financial instruments are financial institutions with strong credit ratings. The Company maintains control over the size of positions entered into with any one counterparty and regularly monitors the credit ratings of these institutions. The Company also utilizes foreign currency forward contracts to manage the risk associated with exposures to foreign currency risk related to intercompany debt and associated interest payments and certain accounts receivable, as well as diesel swap contracts to manage the risk associated with fluctuations in the prices of diesel fuel used in the transportation of its finished products to customers. However, these foreign currency forward contracts and diesel swap contracts are not material to the Consolidated Financial Statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

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

The Company is exposed to changes in interest rates on its variable rate debt. In order to manage this risk, on August 8, 2011, the Company entered into a four-year interest rate swap agreement to manage interest costs and the risk associated with changing interest rates. The Company designated this interest rate swap as a cash flow hedge of floating rate borrowings and expects the hedge to be highly effective in offsetting fluctuations in the designated interest payments resulting from changes in the benchmark interest rate. The gains and losses on the designated swap agreement will offset losses and gains on the transactions being hedged. The Company formally documented the effectiveness of this qualifying hedge instrument (both at the inception of the swap and on an ongoing basis) in offsetting changes in cash flows of the hedged transaction. The fair value of the interest rate swap is calculated as described in Note 6, "Fair Value Measurements," taking into consideration current interest rates and the current creditworthiness of the counterparties or the Company, as applicable.

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

As of March 31, 2013 and December 31, 2012, the fair value of the Company's derivative instruments included in the accompanying Condensed Consolidated Balance Sheets were recorded as follows:

(in millions)

	Liability Derivatives		
	Balance Sheet Location	Fair Value	
		March 31, 2013	December 31, 2012
Derivatives designated as hedging instruments			