

TEMPUR PEDIC INTERNATIONAL INC
Form 10-K
February 29, 2008

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

FORM 10-K

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

For the fiscal year ended December 31, 2007
Commission file number 001-31922

TEMPUR-PEDIC INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

33-1022198
(I.R.S. Employer
Identification No.)

1713 Jaggie Fox Way
Lexington, Kentucky 40511
(Address of registrant's principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (800) 878-8889
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.01 par value	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities

Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated filer Accelerated filer Non-Accelerated filer Smaller reporting company

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

The aggregate market value of the common equity held by non-affiliates of the registrant on June 29, 2007, computed by reference to the closing price for such stock on the New York Stock Exchange on such date, was approximately \$1,937,627,148.

The number of shares outstanding of the registrant's common stock as of February 22, 2008 was 74,595,057 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the 2008 Annual Meeting of Stockholders, which is to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Form 10-K.

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Special Note Regarding Forward-Looking Statements

This annual report on Form 10-K, including the information incorporated by reference herein, contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which include information concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, the impact of the adoption of recently issued accounting pronouncements, the putative securities and antitrust class action lawsuits, related and other lawsuits and pending tax assessments, statements relating to the impact of initiatives to accelerate growth, expand market share and attract sales from the standard mattress market, expand business within established accounts and into under-penetrated markets, maintain costs and improve manufacturing productivity, the vertical integration of our business, our ability to source raw materials effectively, the development, rollout and market acceptance of new products, increase in brand awareness, growth in our Healthcare segment, our ability to generate significant cash flow, and the impact of the cash dividend and stock repurchase program and other information that is not historical information. Many of these statements appear, in particular, under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in ITEM 7 of Part II of this report. When used in this report, the words “estimates,” “expects,” “anticipates,” “projects,” “plans,” “intends,” “believes” and variations of such words or similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon our current expectations and various assumptions. There can be no assurance that we will realize our expectations or that our beliefs will prove correct.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Important factors that could cause our actual results to differ materially from those expressed as forward-looking statements are set forth in this report, including under the heading “Risk Factors” under ITEM IA of Part I of this report. There may be other factors that may cause our actual results to differ materially from the forward-looking statements.

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

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

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PART I

ITEM 1. BUSINESS

General

We are the leading manufacturer, marketer and distributor of premium mattresses and pillows which we sell in approximately 80 countries under the TEMPUR® and Tempur-Pedic® brands. We believe our premium mattresses and pillows are more comfortable than standard bedding products because our proprietary, pressure-relieving TEMPUR® material is temperature sensitive, has a high density, and conforms to the body to therapeutically align the neck and spine, thus reducing neck and lower back pain, two of the most common complaints about other sleep surfaces.

We have two reportable operating segments: Domestic and International. These reportable segments are strategic business units that are managed separately based on the fundamental differences in their geographies. The Domestic operating segment consists of our U.S. manufacturing facilities, whose customers include our U.S. distribution subsidiary and certain third party distributors in the Americas. The International segment consists of our manufacturing facility in Denmark, whose customers include all of our distribution subsidiaries and third party distributors outside the Domestic segment. We evaluate segment performance based on Net sales and Operating income. For the results of our business segments, see “ITEM 15. Exhibits and Financial Statement Schedules Note 13, “Business Segment Information”, under Part IV of this report.

We sell our premium mattresses and pillows through four distribution channels in each operating business segment: Retail (furniture and bedding, and specialty stores, as well as department stores); Direct (direct response and internet); Healthcare (chiropractors, medical retailers, hospitals and other healthcare markets); and Third party distributors in countries where we do not sell directly through our own subsidiaries.

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

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

Market Opportunity and Competitive Strengths

Global Market

Most standard mattresses are made using innersprings, and primarily sold through retail furniture and bedding stores. Alternatives to innerspring mattresses include viscoelastic and foam mattresses, airbeds and waterbeds (collectively called specialty or non-innerspring mattress). According to the International Sleep Products Association (ISPA), mattress unit sales were approximately 22.1 million in the U.S. in 2007. We believe a similar number of mattress units were sold outside the U.S. in 2007. We believe over the last four years the specialty mattress category grew at a notably higher rate than the industry as a whole.

The U.S. pillow market has a traditional and a specialty segment. Traditional pillows are generally made of low cost foam or feathers, other than down. Specialty pillows are comprised of all alternatives to traditional pillows, including viscoelastic, foam, sponge rubber and down. We believe the international pillow market is generally the same size as the domestic pillow market, which we estimate to be approximately \$1.1 billion, annually.

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Our Market Position

We are the worldwide leader in specialty sleep, the fastest growing segment of the estimated \$13.0 billion global mattress market. We are focused on developing, manufacturing and marketing advanced sleep surfaces that help improve the quality of life for people around the world. We believe demand for our products is being driven by significant growth in our core demographic market, increased awareness of the health benefits of a better quality mattress and the shift in consumer preference from firmness to comfort. As consumers continue to prefer alternatives to standard innerspring mattresses, our products become more widely available and as our brand gains broader consumer recognition, we expect that our premium products will continue to attract sales from the standard mattress market.

Superior Product Offerings

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

Increasing Global Brand Awareness

We sell our products in approximately 80 countries primarily under the TEMPUR® and Tempur-Pedic® brands. We believe consumers in the U.S. and internationally increasingly associate our brand name with premium quality products that enable better overall sleep. Our TEMPUR® brand has been in existence since 1991 and its global awareness is reinforced by our high level of customer satisfaction, as demonstrated by: recognition received by the Arthritis Foundation, the NASA Space Foundation, Good Housekeeping and Consumers Digest. In addition, our products are recommended by more than 25,000 healthcare professionals worldwide and an independent study reported 95% of our customers surveyed have recommended Tempur-Pedic products to others.

Vertically Integrated Manufacturing and Supply Chain

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

Strong Financial Performance

Our business generates significant cash flow due to the combination of our growing revenues, strong gross and operating margins, low maintenance capital expenditures and limited working capital requirements. Further, our vertically-integrated operations generated an average of approximately \$0.8 million in Net sales per employee in

2007. For the year ended December 31, 2007, our Gross profit margin and Net income margin were 48.3% and 12.8%, respectively, on Net sales of \$1.1 billion. Our strong financial performance gives us the flexibility to invest in our manufacturing operations, enhance our sales force and marketing, invest in information systems and recruit experienced management and other personnel.

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Significant Growth Opportunities

We believe there are significant opportunities to take market share from the innerspring mattress industry as well as other sleep surfaces. Our market share of the overall mattress industry is relatively small in terms of both dollars and units, which we believe provides us with a significant opportunity for growth. By expanding our brand awareness and offering superior sleep surfaces, we believe consumers will continue to adopt our products at an increasing rate, which should expand our market share. As of December 31, 2007, our products were sold in approximately 6,350 furniture and bedding retail stores in the U.S. Within the available market of approximately 10,000 stores, our plan is to increase our total door count to 7,000 to 8,000 over time. As we deepen our penetration of the furniture and bedding market, our growth strategy is increasingly directed to the expansion of business within our established accounts by increasing slots per store, expanding our sales force and trainers as needed and introducing new products. In addition, in the U.S. we have focused the expansion of our distribution into regions where demographic and buying power metrics indicate that we are under penetrated. Internationally, our products are available in approximately 4,990 furniture retail and department stores, out of a total of approximately 7,000 stores we have identified as appropriate targets. As consumers continue their shift toward the purchase of non-innerspring mattress products and sleep surfaces we believe we are well positioned to capitalize on this growth opportunity.

Our Products

Mattresses

Our mattresses represented 69.4% of our worldwide Net sales in 2007 and are our leading product category in growth in recent years. Our mattresses are composed of proprietary multi-layer, temperature sensitive, pressure-relieving TEMPUR® material. We offer several mattress models, some of which are covered by one or more patents and/or patent applications.

In the U.S. our newest mattress offering, 'The AlluraBed by Tempur-Pedic™' was introduced at The World Market in Las Vegas in January 2008 and will be shipping to retailers in the first half of 2008.

Internationally, during the first quarter of 2008, our high end mattress model, the TEMPUR Royale™, and the TEMPUR Scandinavian Supreme™ will be expanded into other international markets. These products were well received in their initial market launches during 2007.

Pillows

Our premium pillow offerings include a variety of styles and represented 12.9% of worldwide Net sales in 2007. Our pillows provide plush and pressure-relieving comfort as the temperature sensitive material molds to the body.

Other Products

Our other products represented 17.7% of our worldwide sales in 2007. This category includes foundations used to support our mattress products, adjustable beds, and many other types of offerings including a variety of cushions and other comfort products. In the U.S. a new adjustable base offering, the 'TEMPUR Advanced Ergo System™', was introduced at The World Market in Las Vegas in January 2008 and will be shipping to retailers in the first half of 2008.

Marketing and Sales

We primarily sell at wholesale through three distinct channels: Retail, Healthcare and Third Party. We market directly to consumers in the U.S. and the United Kingdom through our Direct channel. Our marketing strategy is to increase

consumer awareness of the benefits of our products and to further associate our brand name with better overall sleep and premium quality products. We launched our new media campaign in the Domestic segment during 2007. This campaign will continue to be implemented in the U.S. and rolled out across many of our international markets during 2008. Based on our analysis of the best ways to reach our target demographic market, we have begun advertising on national network television in the U.S.

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Retail

This is our fastest growing channel and is driven by a sales team dedicated to introducing our products to retailers. We work with and target furniture and bedding retailers, specialty stores, and department stores, among others. Our Retail channel represented 83.1% of Net sales in 2007.

Direct

This channel sells products directly to consumers through our call center operations and the internet in the U.S. and the United Kingdom. Our direct response program targets customers in these markets through television, radio, magazine and newspaper product offering advertisements. Our Direct channel represented 7.2% of Net sales in 2007.

Healthcare

We sell to hospitals, nursing homes, healthcare professionals and medical retailers that utilize our products to treat patients, or may recommend or sell them to their clients. In addition, in the U.S. we are partnering with healthcare vendors in a sales method whereby the vendor integrates our TEMPUR® material into their products to improve patient comfort and wellness. This channel represented 4.6% of Net sales in 2007.

Third Party

Third party sales represented 5.1% of Net sales in 2007. We utilize third party distributors to serve markets that are currently outside the range of our wholly-owned subsidiaries. Our approach to these developing markets has allowed us to build sales, marketing and brand awareness with minimal capital risk. We have entered into written and verbal arrangements with third party distributors located in approximately 65 countries.

Seasonality

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

Operations

Manufacturing and Related Technology

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

Suppliers

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

Research and Development

We opened a new research and development center located in Duffield, Virginia. This project was completed in January 2007. This facility is designed to facilitate detailed product testing and analysis utilizing state-of-the-art technology. In addition to our research and development efforts, we also devote significant efforts to product development as part of our sales and marketing operations. Research and development expenses, excluding product development, were \$5.9 million, \$3.7 million and \$2.7 million in 2007, 2006 and 2005, respectively. In 2008, we plan to increase our spending on research and development efforts in order to continue providing superior and innovative mattress and pillow products to our target markets.

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Competition

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

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

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

Intellectual Property

We hold various U.S. and foreign patents and patent applications regarding certain elements of the design and function of many of our mattress and pillow products. As of December 31, 2007, we held 15 U.S. patents, expiring at various points between 2013 and 2025, and had 15 U.S. patent applications pending. We also held 55 foreign patents and had 44 foreign patent applications pending.

As of December 31, 2007, we held 411 trademark registrations worldwide, which we believe have significant value and are important to the marketing of our products to retailers. TEMPUR® and Tempur-Pedic® are trademarks registered with the United States Patent and Trademark Office. We have a number of other U.S. applications pending or registrations existing for our trademarks, including ‘The CelebrityBed by Tempur-Pedic™’ and other key product models. Swedish Sleep System,® Tempur-Med® and the Tempur-Pedic logo are also registered in the U.S. and various countries worldwide. In addition, we have U.S. applications pending for additional marks. Several of our trademarks have been registered, or are the subject of pending applications, in various foreign countries. Each U.S. trademark registration is renewable indefinitely as long as the mark remains in use.

Governmental Regulation

Our operations are subject to state, local and foreign consumer protection and other regulations relating to the mattress and pillow industry. These regulations vary among the states and countries in which we do business. The regulations generally impose requirements as to the proper labeling of bedding merchandise, restrictions regarding the identification of merchandise as “new” or otherwise, controls as to hygiene and other aspects of product handling and sale and penalties for violations. The U.S. Consumer Product Safety Commission has adopted new rules relating to fire retardancy standards for the mattress and pillow industry. The State of California similarly adopted new fire retardancy standards in 2005. We have developed and implemented product modifications that allow us to meet these new standards. Many foreign jurisdictions also regulate fire retardancy standards, and changes to these standards and

changes in our products that require compliance with additional standards would raise similar risks. We are also subject to environmental and health and safety requirements with regard to the manufacture of our products. We have made and will continue to make capital and other expenditures necessary to comply with all these requirements. We believe that we are in substantial compliance with the applicable federal, state, local, and foreign rules and regulations governing our business.

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Employees

As of December 31, 2007, we had approximately 1,400 employees, with approximately 700 in the U.S., 300 in Denmark and 400 in the rest of the world. Certain of our employees in Denmark are covered by a government labor union contract as required by Danish law. None of our U.S. employees are covered by a collective bargaining agreement. We believe our relations with our employees are generally good.

Executive Officers of the Registrant

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

Name	Age	Position
H. Thomas Bryant	60	President and Chief Executive Officer
Matthew D. Clift	48	Executive Vice President of Global Operations
David Montgomery	47	Executive Vice President and President of International Operations
Richard W. Anderson	48	Executive Vice President and President, North America
Dale E. Williams	45	Executive Vice President, Chief Financial Officer, and Secretary
Bhaskar Rao	42	Chief Accounting Officer and Vice President of Strategic Planning

H. Thomas Bryant joined Tempur-Pedic International in July 2001. In April 2006, Mr. Bryant was promoted to the role of Chief Executive Officer and elected a member of the board of directors. From July 2001 to December 2004, Mr. Bryant served as Executive Vice President and President of North American Operations. From December 2004 to April 2006, Mr. Bryant served as President of Tempur-Pedic International. Prior to joining Tempur-Pedic International, from 1998 to 2001, Mr. Bryant was the President and Chief Executive Officer of Stairmaster Sports & Medical Products, Inc. From 1989 to 1997, Mr. Bryant served in various senior management positions at Dunlop Maxfli Sports Corporation, most recently as President. Prior to that, Mr. Bryant spent 15 years in various management positions at Johnson & Johnson. Mr. Bryant received his B.S. degree from Georgia Southern University. In February 2008, Mr. Bryant announced his plan to retire as President and Chief Executive Officer effective mid-year 2008. The Company anticipates that Mr. Bryant will continue to serve as a director and stand for re-election at the annual meeting of stockholders in May 2008.

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

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

Richard W. Anderson joined Tempur-Pedic International in July 2006 and serves as Executive Vice President and President, North America. From 1983 to 2006, Mr. Anderson was employed by The Gillette Company, which became a part of Procter & Gamble in 2005. Mr. Anderson most recently served as a Vice President of Marketing for Oral-B and Braun in North America. Previously, Mr. Anderson was Vice President of Global Business Management for

Duracell. Mr. Anderson has held several management positions in marketing and sales as well as overseeing branding, product development and strategic planning. Mr. Anderson obtained B.S. and M.B.A. degrees from Virginia Tech.

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Dale E. Williams joined Tempur-Pedic International in July 2003 and serves as Executive Vice President, Chief Financial Officer and Secretary. From 2001 to September 2002, Mr. Williams served as Vice President and Chief Financial Officer of Honeywell Control Products, a division of Honeywell International, Inc. From September 2002, when he left Honeywell in connection with a reorganization, to July 2003, Mr. Williams received severance from Honeywell and was not employed. From 2000 to 2001, Mr. Williams served as Vice President and Chief Financial Officer of Saga Systems, Inc./Software AG, Inc. Prior to that, Mr. Williams spent 15 years in various management positions at General Electric Company, most recently as Vice President and Chief Financial Officer of GE Information Services, Inc. Mr. Williams received his B.A. degree in finance from Indiana University.

Bhaskar Rao joined Tempur-Pedic International in January 2004 as Director of Financial Planning and Analysis. In October 2005, Mr. Rao was promoted to Vice President of Strategic Planning. In May 2006, Mr. Rao was promoted to the position of Chief Accounting Officer and continues to serve as Vice President of Strategic Planning. From 2002 until December 2003, Mr. Rao was employed by Ernst & Young as a Senior Manager in the assurance and business advisory group. Mr. Rao was employed by Arthur Anderson from 1994 until 2002. Mr. Rao graduated from Bellarmine University with B.A. degrees in Accounting and Economics. Mr. Rao is also a Certified Public Accountant.

ITEM 1A. RISK FACTORS

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

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

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

Our largest competitors have significant financial, marketing and manufacturing resources. They enjoy strong brand name recognition, and sell their products through broad and well established distribution channels. Additionally, a number of our significant competitors now offer mattress products claimed to be similar to our viscoelastic mattresses and pillows. These competitors or other mattress manufacturers may aggressively pursue the viscoelastic mattress market or may pursue the specialty sleep segment with other products, including latex and air mattresses. Any such competition by established manufacturers or new entrants into the market could have a material adverse effect on our business, financial condition and operating results by causing our products to lose market share. In addition, should any of our competitors reduce price on premium mattress products, we may elect to implement price reductions in order to remain competitive, which could significantly impair our liquidity and profitability. The pillow industry is characterized by a large number of competitors, none of which are dominant, but many of which have greater resources than us and greater brand recognition than our brand.

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

Our ability to service our indebtedness depends on our ability to maintain our profitability. We may not be able to maintain our profitability on a quarterly or annual basis in future periods. Further, our profitability will depend upon a

number of factors, including without limitation:

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- the level of competition in the mattress and pillow industry;
- our ability to continue to successfully execute our strategic initiatives;
- our ability to effectively sell our products through our distribution channels in volumes sufficient to drive growth and leverage our cost structure and advertising spending;
- our ability to continuously improve our products to offer new and enhanced consumer benefits, better quality and reduced costs;
- our ability to maintain efficient, timely and cost-effective production and utilization of our manufacturing capacity;
- the efficiency and effectiveness of our advertising campaigns and other marketing programs in building product and brand awareness, driving traffic to our distribution channels and increasing sales;
- our ability to successfully identify and respond to emerging trends in the mattress and pillow industry;
- our ability to maintain public association of our brand with premium products, including overcoming any impact on our brand caused by some of our customers seeking to sell our products at a discount to our recommended price;
- the level of consumer acceptance of our products; and
- general economic conditions and consumer confidence.

Our sales growth is increasingly dependent on our ability to increase product sales in our existing retail accounts.

A source of our growth over the last few years has been through expanding distribution of our products into new stores, principally furniture and bedding retail stores in the U.S. Our products are sold in approximately 4,990 retail store internationally. Our products are currently sold in approximately 6,350 furniture and bedding retail stores in the U.S., and our plan is to increase our total penetration to a total of 7,000 to 8,000 over time. As we approach this target, our sales growth will increasingly depend on our ability to generate additional sales in our existing accounts in the Retail channel. If we are unable to increase product sales in our existing retail accounts at a sufficient rate overall, our Net sales growth could slow, which could adversely affect the price of our common stock.

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

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

In addition to seasonal fluctuations, the demand for our premium products can fluctuate significantly based on a number of other factors, including general economic conditions and consumer confidence, and the timing of price increases announced by us or our competitors. We believe that as our consumer base continues to expand the average demographics of our consumer base will change, and be comprised of a greater percentage of middle income consumers. This change in our consumer base makes our business more susceptible to general economic factors that impact disposable income or consumer confidence.

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

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

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

The major raw materials that we purchase for production are chemicals and proprietary additives. The price and availability of these raw materials are subject to market conditions affecting supply and demand, and prices have risen substantially on certain materials since August 2005. Our financial condition and results of operations may be materially and adversely affected by increases in raw material costs to the extent we are unable to absorb those increases and/or pass those higher costs to our customers.

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

We acquire chemicals and proprietary additives from a number of suppliers with manufacturing locations around the world. If we were unable to obtain chemicals and proprietary additives from these suppliers, we would have to find replacement suppliers. Any substitute arrangements for chemicals and proprietary additives might not be on terms as favorable to us. We maintain relatively small supplies of our raw materials at our manufacturing facilities, and any disruption in the on-going shipment of supplies to us could interrupt production of our products, which could result in a decrease of our sales, or could cause an increase in our cost of sales, and either of which could decrease our liquidity and profitability. In addition, we continue to outsource the procurement of certain goods and services, particularly mattress and pillow covers, from suppliers in foreign countries. If we were no longer able to outsource through suppliers, we could source it elsewhere, perhaps at a higher cost. To the extent we are unable to absorb those higher costs, or pass any such higher costs to our customers, our gross profit margin could be negatively affected, which could result in a decrease in our liquidity and profitability.

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

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

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

Approximately 34.5% of our Net sales were denominated in foreign currency for the year ended December 31, 2007. As a multinational company, we conduct our business in a wide variety of currencies and are therefore subject to market risk for changes in foreign exchange rates. We use foreign exchange forward contracts to manage a portion of the exposure to the risk of the eventual net cash inflows and outflows resulting from foreign currency denominated

transactions between Tempur-Pedic International subsidiaries and their customers and suppliers, as well as between Tempur-Pedic International subsidiaries themselves from time to time. The hedging transactions may not succeed in managing our foreign currency exchange rate risk. See “ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Foreign Currency Exposures” in Part II of this report.

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Foreign currency exchange rate movements also create a degree of risk by affecting the U.S. dollar value of sales made and costs incurred in foreign currencies. We do not enter into hedging transactions to hedge this risk. Consequently, our reported earnings and financial position could fluctuate materially as a result of foreign exchange gains or losses. Our outlook assumes no significant variance to 2007 currency exchange rates over the course of the year. Should currency rates change sharply, our results could be negatively impacted. See “ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Foreign Currency Exposures” in Part II of this report.

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

Our products and our marketing and advertising programs are and will continue to be subject to regulation in the U.S. by various federal, state and local regulatory authorities, including the Federal Trade Commission and the U.S. Food and Drug Administration. In addition, other governments and agencies in other jurisdictions regulate the sale and distribution of our products. Compliance with these regulations may have an adverse effect on our business. For example, the U.S. Consumer Product Safety Commission has adopted new rules relating to fire retardancy standards for the mattress and pillow industry. The State of California similarly adopted new fire retardancy standards in 2005. We developed product modifications that allow us to meet these new standards. Required product modifications have added cost to our products. Many foreign jurisdictions also regulate fire retardancy standards, and changes to these standards and changes in our products that require compliance with additional standards would raise similar risks.

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

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

Part of our Domestic marketing and advertising strategy in certain Domestic channels focuses on providing up to a 120-day money back guarantee under which customers may return their mattress and obtain a refund of the purchase price. For the year ended December 31, 2007, we had approximately \$41.1 million in returns for a return rate of approximately 5.7% of our Net sales in the U.S. As we expand our sales, our return rates may not remain within our historical levels. An increase in return rates could significantly impair our liquidity and profitability. We also currently provide our customers with a limited, pro-rata 20-year warranty on mattresses sold in the U.S. and a limited 15-year warranty on mattresses sold outside of the U.S. However, as we have only been selling mattresses in significant quantities since 1992, and have released new products in recent years, many are fairly early in their product life cycles. We also provide 2-year to 3-year warranties on pillows.

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

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

We currently conduct international operations in approximately 80 countries, and we continue to pursue additional international opportunities. We generated approximately 34.5% of our Net sales from non-U.S. operations during the year ended December 31, 2007. Our international operations are subject to the customary risks of operating in an international environment, including complying with foreign laws and regulations and the potential imposition of trade or foreign exchange restrictions, tariff and other tax increases, fluctuations in exchange rates, inflation and unstable political situations, and labor issues.

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On October 24, 2007, we received an income tax assessment from the Danish Tax Authority with respect to the 2001, 2002 and 2003 tax years. The tax assessment relates to the royalty paid by our U.S. companies to our Danish subsidiary and the position taken by the Danish Tax Authority could apply to subsequent years. Management is currently evaluating the assessment. We believe we have meritorious defenses to the proposed adjustment and will oppose the assessment in the Danish courts. However, there is a reasonable possibility that the amount of unrecognized tax benefits relating to this matter may change in the next twelve months. An estimate of the amount of such change cannot be made at this time.

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

We rely on trade secrets to protect the design, technology and function of our TEMPUR® material and our products. To date, we have not sought U.S. or international patent protection for our principal product formula and manufacturing processes. Accordingly, we may not be able to prevent others from developing viscoelastic material and products that are similar to or competitive with our products. Our ability to compete effectively with other companies also depends, to a significant extent, on our ability to maintain the proprietary nature of our owned and licensed intellectual property. We own several patents on aspects of our products and have patent applications pending on aspects of our products and manufacturing processes. However, the principal product formula and manufacturing processes for our TEMPUR® material and our products are not patented and we must maintain these as trade secrets in order to protect this intellectual property. We own 15 U.S. patents, and we have 15 U.S. patent applications pending. Further, we own 55 foreign patents, and we have 44 foreign patent applications pending. In addition, we hold 411 trademark registrations worldwide. We own U.S. and foreign registered trade names and service marks and have applications for the registration of trade names and service marks pending domestically and abroad. We also license certain intellectual property rights from third parties.

Our trademarks are currently registered in the U.S. and registered or pending in 123 foreign jurisdictions. However, those rights could be circumvented, or violate the proprietary rights of others, or we could be prevented from using them if challenged. A challenge to our use of our trademarks could result in a negative ruling regarding our use of our trademarks, their validity or their enforceability, or could prove expensive and time consuming in terms of legal costs and time spent defending against such a challenge. Any loss of trademark protection could result in a decrease in sales or cause us to spend additional amounts on marketing, either of which could decrease our liquidity and profitability. In addition, if we incur significant costs defending our trademarks, that could also decrease our liquidity and profitability. In addition, we may not have the financial resources necessary to enforce or defend our trademarks. Furthermore, our patents may not provide meaningful protection and patents may never issue from pending applications. It is also possible that others could bring claims of infringement against us, as our principal product formula and manufacturing processes are not patented, and that any licenses protecting our intellectual property could be terminated. If we were unable to maintain the proprietary nature of our intellectual property and our significant current or proposed products, this loss of a competitive advantage could result in decreased sales or increased operating costs, either of which would decrease our liquidity and profitability.

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

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

Our top five customers, collectively, accounted for 18.2% of our Net sales for the year ended December 31, 2007, and a portion of our growth in 2007 in our Retail channel was due to the growth of Net sales to our largest accounts. Many of our customer arrangements are by purchase order or are terminable at will at the option of either party. A substantial decrease or interruption in business from our significant customers could result in the loss of future business and could reduce our liquidity and profitability.

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In the future, retailers may consolidate, undergo restructurings or reorganizations, experience financial difficulty, or realign their affiliations, any of which could decrease the number of stores that carry our products or increase the ownership concentration in the retail industry. Some of these retailers may decide to carry only a limited number of brands of mattress products, which could affect our ability to sell our products to them on favorable terms, if at all. Our loss of significant customers would impair our sales and profitability and have a material adverse effect on our business, financial condition and results of operations.

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

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

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

As of December 31, 2007, we had approximately 1,400 full-time employees, with approximately 700 in the U.S., 300 in Denmark and 400 in the rest of the world. Certain of our employees in Denmark are under a government labor union contract, but those in the U.S. are not. Any significant increase in our labor costs could decrease our liquidity and profitability and any deterioration of employee relations, slowdowns or work stoppages at any of our locations, whether due to union activities, employee turnover or otherwise, could result in a decrease in our Net sales or an increase in our costs, either of which could decrease our liquidity and profitability.

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

We depend on the continued services of our senior management team. The loss of key personnel could have a material adverse effect on our ability to execute our business strategy and on our financial condition and results of operations. We do not maintain key-person insurance for members of our senior management team. In addition, the recent announcement of our President and Chief Executive Officer's decision to retire effective mid-year 2008 may have an impact on our ability to execute our business strategy. Our board of directors will be required to devote time to conducting a search for a successor President and Chief Executive Officer. Our leverage limits our flexibility and increases our risk of default.

As of December 31, 2007, we had \$602.0 million in total Long-term debt outstanding. In addition, as of December 31, 2007, our Stockholders' Equity was \$48.1 million. Between October 2005 and November 30, 2007, we repurchased a total of \$540.0 million in common stock pursuant to stock repurchase authorizations authorized by our Board of Directors. We funded the repurchase in part through borrowings under our 2005 Senior Credit Facility, which has substantially increased our leverage. On October 16, 2007, our Board of Directors authorized an additional stock repurchase of up to \$300.0 million of our common stock. Our Board of Directors may authorize additional share repurchases in the future and we may fund these repurchases with debt. In addition, in the first quarter of 2007 our Board of Directors initiated a \$0.24 cash dividend, paid in quarterly installments of \$0.06. In the second quarter of 2007, our Board of Directors increased the quarterly dividend payment to \$0.08. We paid a total of \$23.8 million in dividends in 2007. Our Board has declared a dividend of \$0.08 for the first quarter of 2008.

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

- limiting our ability to obtain in the future additional financing we may need to fund future working capital, capital expenditures, product development, acquisitions or other corporate requirements; and
- requiring the dedication of a substantial portion of our cash flow from operations to the payment of principal and interest on our debt, which will reduce the availability of cash flow to fund working capital, capital expenditures, product development, acquisitions and other corporate requirements.

In addition, the instruments governing our debt contain financial and other restrictive covenants, which limit our operating flexibility and could prevent us from taking advantage of business opportunities. In addition, our failure to comply with these covenants may result in an event of default. If such event of default is not cured or waived, we may suffer adverse effects on our operations, business or financial condition, including acceleration of our debt.

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

We are subject to interest rate risk in connection with our issuance of variable rate debt under our 2005 senior credit facility. Interest rate changes could increase the amount of our interest payments and thus, negatively impact our future earnings and cash flows. We estimate that our annual interest expense on our floating rate indebtedness would increase by \$6.0 million for each 1.0% increase in interest rates. See “ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk—Interest Rate Risk” in Part II of this report.

Allegations of price fixing in the mattress industry could adversely affect our operations.

Our retail pricing policies are subject to antitrust regulations in the U.S. and abroad. If antitrust regulators in any jurisdiction in which we do business initiate investigations into or challenge our pricing or advertising policies, our efforts to respond could force us to divert management resources and we could incur significant unanticipated costs. If such an investigation were to result in a charge that our practices or policies were in violation of applicable antitrust laws or regulations, we could be subject to significant additional costs of defending such charges in a variety of venues and, ultimately, if there were a finding that we were in violation of antitrust laws or regulations, there could be an imposition of fines, damages for persons injured, as well as injunctive or other relief. Any requirement that we pay fines or damages could decrease our liquidity and profitability, and any investigation that requires significant management attention or causes us to change our business practices could disrupt our operations, also resulting in a decrease in our liquidity and profitability. An antitrust class action suit against us could result in potential liabilities, substantial costs and the diversion of our management’s attention and resources, regardless of the outcome. See ITEM 3, “Legal Proceedings” in Part I of this report.

General business and economic conditions could reduce our sales and profitability..

Our business can be affected by general business and economic conditions, both in the United States and abroad. Given the extent of our business in the United States, we could be exposed to downturns in the United States economy which could have a significant adverse impact on demand for our products. In addition in a poor economic environment there is a greater likelihood that more of our customers or retailers could become delinquent on their obligations to us or go bankrupt, which, in turn, could result in a higher level of charge-offs and provision for credit losses, all of which would adversely affect our earnings. General business and economic conditions that could affect us include short-term and long-term interest rates, inflation, fluctuations in both debt and equity capital markets, and the strength of the U.S. economy and the local economies in which we operate.

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

The trading price of our common stock is likely to continue to be volatile and subject to wide price fluctuations. The trading price of our common stock may fluctuate significantly in response to various factors, including:

- actual or anticipated variations in our quarterly operating results, including those resulting from seasonal variations in our business;
- introductions or announcements of technological innovations or new products by us or our competitors;

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- disputes or other developments relating to proprietary rights, including patents, litigation matters, and our ability to patent our products and technologies;
- changes in estimates by securities analysts of our financial performance;
- the declaration of a cash dividend and stock repurchase program;
- conditions or trends in the specialty bedding industry, or the mattress industry generally;
- additions or departures of key personnel;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- announcements by our competitors of their quarterly operating results or announcements by our competitors of their views on trends in the bedding industry;
- regulatory developments in the U.S. and abroad;
- economic and political factors; and
- public announcements or filings with the SEC indicating that significant stockholders, directors or officers are selling shares of our common stock.

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

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit against us could result in potential liabilities, substantial costs, and the diversion of our management's attention and resources, regardless of the outcome. See ITEM 3, "Legal Proceedings" in Part I of this report.

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

The market price of our common stock could decline as a result of sales of substantial amounts of our common stock in the public market, or the perception that these sales could occur. In addition, these factors could make it more difficult for us to raise funds through future offerings of common stock. As of February 22, 2008, there were 74,595,057 shares of our common stock outstanding. All of our shares of our common stock are freely transferable without restriction or further registration under the Securities Act of 1933, except for certain shares of our common stock which were purchased by our executive officers, directors, principal stockholders, and some related parties.

In addition, on December 24, 2003, we registered up to 14,983,532 shares of our common stock reserved for issuance upon the exercise of options previously granted under our 2002 Stock Option Plan and the exercise of options granted or reserved for grant under our 2003 Equity Incentive Plan and our 2003 Employee Stock Purchase Plan. In December 2003, the Board adopted a resolution that prohibited further being made under the 2002 Stock Option Plan. Stockholders can sell these shares in the public market upon issuance, subject to restrictions under the securities laws.

In 2007, one of our largest stockholders, a private equity fund that invested in our Company in 2002 in connection with the acquisition of our predecessor, made a distribution of our common stock to their investors totaling 5,275,000 shares. This shareholder continues to hold 4,479,187 shares of common stock and may choose to make additional distributions or sales of our common stock in the future.

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

As of February 22, 2008, our executive officers, directors, and their respective affiliates, including one of our largest stockholders, own, in the aggregate, approximately 11% of our outstanding common stock on a fully diluted basis, after giving effect to the vesting of all unvested options. These stockholders, as a group, are able to influence all matters requiring approval by our stockholders, including mergers, sales of assets, the election of all directors, and approval of other significant corporate transactions, in a manner with which you may not agree or that may not be in your best interest.

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

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

These provisions include:

- our ability to issue preferred stock with rights senior to those of the common stock without any further vote or action by the holders of our common stock;
- the requirements that our stockholders provide advance notice when nominating our directors; and
- the inability of our stockholders to convene a stockholders’ meeting without the chairperson of the board, the president, or a majority of the board of directors first calling the meeting.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We operate in approximately 80 countries and have wholly-owned subsidiaries in 18 countries, including our wholly-owned subsidiaries that own our manufacturing facilities in Denmark and the U.S. The following table sets forth certain information regarding our principal facilities at December 31, 2007.

We believe that our existing properties are suitable for the conduct of our business, are adequate for our present needs and will be adequate to meet our future needs. As described in ITEM 7., “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, we operate in two business segments, Domestic and International. Our Domestic operating segment consists of our U.S. manufacturing facilities and our Corporate office operating expenses. Our International operating segment consists of our manufacturing facility in Denmark.

Name/Location	Approximate Square Footage	Title	Type of Facility
Tempur Production USA, Inc. Duffield, Virginia	540,000	Owned	Manufacturing
Tempur Production USA, Inc.	800,000	Leased (until 2035)	Manufacturing

Albuquerque, New Mexico

Dan-Foam ApS

Aarup, Denmark

517,000

Owned

Manufacturing

Tempur-Pedic North America, Inc.

Lexington, Kentucky

72,000

Leased (until 2009)

Office

Tempur Deutschland GmbH

Steinhagen, Germany

121,000

Owned

Office and Warehouse

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In addition to the properties listed above, we have 25 facilities in 15 countries under leases with one to ten year terms. The manufacturing facility in Albuquerque, New Mexico is leased as part of the related industrial revenue bond financing. We have an option to repurchase the property for one dollar upon repayment of the financing.

ITEM 3. LEGAL PROCEEDINGS

Securities Law Action – Between October 7, 2005 and November 21, 2005, five complaints were filed against Tempur-Pedic International and certain of its directors and officers in the United States District Court for the Eastern District of Kentucky (Lexington Division) purportedly on behalf of a class of shareholders who purchased Tempur-Pedic International’s stock between April 22, 2005 and September 19, 2005 (the "Securities Law Action"). These actions were consolidated, and a consolidated complaint was filed on February 27, 2006 asserting claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Lead plaintiffs allege that certain of Tempur-Pedic International’s public disclosures regarding its financial performance between April 22, 2005 and September 19, 2005 were false and/or misleading. On December 7, 2006 lead plaintiffs were permitted to file an amended complaint. We filed a motion to dismiss the Securities Law Action which has been fully briefed, and are now awaiting a decision on that motion. The plaintiffs seek compensatory damages, costs, fees and other relief within the Court’s discretion. We strongly believe that the Securities Law Action lacks merit, and intend to defend against the claims vigorously. However, due to the inherent uncertainties of litigation, we cannot predict the outcome of the Securities Law Action at this time, and can give no assurance that these claims will not have a material adverse affect on our financial position or results of operations or liquidity. Accordingly, we cannot make an estimate of the possible ranges of loss.

Derivative Complaints – On November 10, 2005 and December 15, 2005, complaints were filed in the state courts of Delaware and Kentucky, respectively, against certain officers and directors of Tempur-Pedic International, purportedly derivatively on behalf of the Company (the Derivative Complaints). The Derivative Complaints assert that the named officers and directors breached their fiduciary duties when they allegedly sold Tempur-Pedic International’s securities on the basis of material non-public information in 2005. In addition, the Delaware Derivative Complaint asserts a claim for breach of fiduciary duty with respect to the disclosures that also are the subject of the Securities Law Action described above. On December 14, 2005 and January 26, 2006, respectively, the Delaware court and Kentucky court stayed these derivative actions. Although the Kentucky court action remains stayed, the Delaware court action stay was lifted by the Court and the plaintiffs filed an amended complaint on April 5, 2007. The Company responded by filing a motion to stay or dismiss the Delaware court action on April 19, 2007. The Delaware court again stayed the Delaware action on February 6, 2008. Tempur-Pedic International is also named as a nominal defendant in the Derivative Complaints, although the actions are derivative in nature and purportedly asserted on behalf of Tempur-Pedic International. Accordingly, we cannot make an estimate of the possible ranges of loss.

Antitrust Action – On January 5, 2007, a purported class action was filed against the Company in the United States District Court for the Northern District of Georgia, Rome Division (Jacobs v. Tempur-Pedic International, Inc. and Tempur-Pedic North America, Inc., or the “Antitrust Action”). The Antitrust Action alleges violations of federal antitrust law arising from the pricing of Tempur-Pedic mattress products by Tempur-Pedic North America and certain distributors. The action alleges a class of all purchasers of Tempur-Pedic mattresses in the United States since January 5, 2003, and seeks damages and injunctive relief. Count Two of the complaint was dismissed by the court on June 25, 2007, based on a motion filed by the Company. Following a decision issued by the United States Supreme Court in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.* on June 28, 2007, we filed a motion to dismiss the remaining two counts of the Antitrust Action on July 10, 2007. On December 11, 2007, that motion was granted and, as a result, judgment was entered in favor of the Company and the plaintiffs’ complaint was dismissed with prejudice. On December 21, 2007, the Plaintiffs filed a “Motion to Alter or Amend Judgment,” which has been fully briefed. We continue to strongly believe that the Antitrust Action lacks merit, and intend to defend against the claims vigorously. However, due to the inherent uncertainties of litigation, we cannot predict the outcome of the Antitrust Action at this time, and can give no assurance that these claims will not have a material adverse affect on our financial position or

results of operation. Accordingly, we cannot make an estimate of the possible ranges of loss.

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

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of 2007.

PART II

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

Market for Registrant's Common Equity

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

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

	Price Range		Cash Dividend Per Common Share
	High	Low	
Fiscal 2006			
First Quarter	\$ 14.50	\$ 11.19	\$ —
Second Quarter	\$ 15.89	\$ 13.47	\$ —
Third Quarter	\$ 18.12	\$ 13.11	\$ —
Fourth Quarter	\$ 21.41	\$ 17.45	\$ —
Fiscal 2007			
First Quarter	\$ 27.11	\$ 20.29	\$ 0.06
Second Quarter	\$ 28.41	\$ 24.34	\$ 0.08
Third Quarter	\$ 36.86	\$ 26.68	\$ 0.08
Fourth Quarter	\$ 37.38	\$ 25.97	\$ 0.08

As of December 31, 2007, we had approximately 142 shareholders of record of our common stock.

Dividends

On February 18, 2008, our Board of Directors declared a cash dividend of \$0.32, and the first quarter dividend of \$0.08 will be distributed on March 14, 2008 to stockholders of record as of February 27, 2008. This annual cash dividend program may be limited, suspended, or terminated at any time without prior notice.

In the first quarter of 2007, our Board of Directors initiated a cash dividend of \$0.24, paid in quarterly installments of \$0.06. In the second quarter of 2007, our Board of Directors increased the quarterly dividend payment to \$0.08. The same dividend was declared in the third and fourth quarter of 2007. Prior to 2007, we had never previously declared a cash dividend for our common stock.

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Equity Compensation Plan Information

The following table sets forth equity compensation plan information as of December 31, 2007:

Plan category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	4,602,716	\$ 17.10	3,653,642
Equity compensation plans not approved by security holders	—	—	—
Total	4,602,716	\$ 17.10	3,653,642

See Note 6 to the Consolidated Financial Statements for information regarding the material features of each of the above plans.

Related Stockholder Matters

Issuer Purchases of Equity Securities

The following table sets forth our purchases of equity securities for the three-months ended December 31, 2007:

Period	(a) Total number of shares purchased	(b) Average Price Paid per Common Share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Maximum number of shares (or approximate dollar value) of shares that may yet be purchased under the plans or programs (in millions)
October 1, 2007 – October 31, 2007	—	\$ —	—	\$ 300.0
November 1, 2007 – November 30, 2007	658,900	30.18	658,900	280.1
December 1, 2007 – December 31, 2007	—	—	—	280.1
Total	658,900		658,900	

On January 25, 2007, our Board of Directors authorized the repurchase of up to \$100.0 million of our common stock. We repurchased 3,840,485 shares of our common stock for a total of \$100.0 million from the January 2007 authorization, and completed purchases from this authorization in June 2007. On July 19, 2007, our Board of Directors authorized an additional share repurchase authorization to repurchase up to \$200.0 million of our common stock. We repurchased 6,561,489 shares of our common stock for a total of \$200.0 million from the July 2007

authorization and completed purchases from this authorization in September 2007. On October 16, 2007, our Board of Directors authorized an additional share repurchase authorization of up to \$300.0 million of our common stock. The share repurchases were funded from borrowings under the 2005 Senior Credit Facility and funds from operations. Share repurchases under these authorizations may be made through open market transactions, negotiated purchases or otherwise, at times and in such amounts as we, and a committee of the Board, deem appropriate. This share repurchase program may be suspended, limited or terminated at any time without notice. As of February 22, 2008, we have repurchased 658,900 shares for a total of \$19.9 million under the October authorization.

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On October 18, 2005, our Board of Directors authorized the repurchase of up to \$80.0 million of our common stock. Share repurchases under this program were made through open market transactions, negotiated purchases or otherwise, at times and in such amounts as we, and a committee of the Board, deemed appropriate. During 2005, we repurchased 6,839,900 shares, at a total cost of \$76.0 million. On January 25, 2006, our Board of Directors amended the share repurchase program described above to increase the total authorization by an additional \$100.0 million. On May 22, 2006, our Board of Directors further amended the share repurchase program to increase the total authorization under the share repurchase program by an additional \$40.0 million for a total authorization to purchase up to \$220.0 million of our common stock. During the twelve-months ended December 31, 2006, we repurchased 11,275,124 shares at a total cost of \$144.0 million. As of December 31, 2006, we had completed our existing share repurchase authorization. The share repurchases were funded from borrowings under the 2005 Senior Credit Facility and funds from operations.

Performance Graph

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

The following table compares cumulative shareholder returns for the Company over the last four years to the S&P 500 Stock Composite Index, an old peer group, and a new peer group. The S&P 500 Composite Index is a capitalization weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the U.S. economy, and are chosen for market size, liquidity and industry group representation.

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

New Peer Group

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

Old Peer Group

Bassett Furniture Industries, Incorporated	Furniture Brands International, Inc.	Natuzzi S.P.A
Chromcraft Revington, Inc.	Hooker Furniture Corporation	The Rowe Companies
Color Kinetics Incorporated	Hubbell Incorporated	Select Comfort Corporation
Empire Global Corp.	La-Z-Boy Incorporated	

Stanley Furniture Company,
Inc.

Ethan Allen Interiors, Inc. Leggett & Platt, Incorporated Tempur-Pedic International
Inc.

Flexsteel Industries Inc. Lighting Science Group Xenonics Holdings, Inc.
Corporation

We decided to use a new peer group for the year ended December 31, 2007. We believe the new peer group more closely reflects our business and, as a result, provides a more meaningful comparison of stock performance. In accordance with Securities and Exchange Commission rules, the graph includes both the old peer group and the new peer group. The comparison for each of the periods assumes that \$100 was invested on December 31, 2003 in our common stock, the stocks included in the S & P 500 Composite Index and the stocks included in each peer group index and that all dividends were reinvested. The stock performance shown on the graph below is not necessarily indicative of future price performance.

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	12/31/2003	12/31/2004	12/31/2005	12/31/2006	12/31/2007
Tempur-Pedic International Inc.	\$ 100.00	\$ 136.77	\$ 74.19	\$ 132.00	\$ 169.43