TEMPUR PEDIC INTERNATIONAL INC
Form 10-K
February 28, 2007
Table of Contents

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, 2006

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.)**

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 x

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 x

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 ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer x Accelerated filer ¨ Non-Accelerated filer ¨

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 aggregate market value of the common equity held by non-affiliates of the registrant on June 30, 2006, computed by reference to the closing price for such stock on the New York Stock Exchange on such date, was approximately $945,604,294.

The number of shares outstanding of the registrant s common stock as of February 26, 2007 was 84,961,267 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for the 2007 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.

TABLE OF CONTENTS

Table of Contents

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 class action lawsuits, related and other lawsuits, statements relating to the impact of initiatives to accelerate growth, expand market share, maintain costs and improve manufacturing productivity, the rollout and market acceptance of new products, increase in brand awareness, growth in international sales, expectations regarding floor expansion in the retail channel, the impact of increases in raw materials costs, our new manufacturing facility in New Mexico, the existence and realization of our net operating losses, 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 1A of Part I. 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.

Table of Contents

PART I

ITEM 1. BUSINESS

General

We are the leading manufacturer, marketer and distributor of premium mattresses and pillows which we sell globally in over 70 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 North American third party distributors. 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 internationally); 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.

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 mattresses). According to the International Sleep Products Association (ISPA) from 1991 to 2006, mattress unit sales grew in the U.S. at an average of approximately 350,000 units annually, with approximately 21.4 million mattress units sold in the U.S. in 2006. We believe a similar number of mattress units were sold outside the U.S. in 2006. We believe over the last three years the specialty mattress category grew at a significantly 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.

Table of Contents

Our Market Position

We are the worldwide leader in specialty sleep, the fastest growing segment of the estimated $12 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 over 70 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 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, limited working capital requirements, and limited corporate overhead. Further, our vertically-integrated operations generated an average of approximately $0.7 million in Net sales per employee in 2006. For the year ended December 31, 2006, our Gross profit margin and

Net income margin were 49% and 12%, respectively, on Net sales of $945.0 million. In addition, capital expenditures were $37.2 million for the year ended December 31, 2006, of which approximately $19.4 million was related to our New Mexico manufacturing facility, which commenced manufacturing operations in January 2007. 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.

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, 2006, our products were sold in approximately 6,050 furniture and bedding retail stores in the U.S., out of a total of approximately 10,000 stores we have identified as appropriate targets. We expect to enter between 7,000 and 8,000 of these targeted stores over time. As we deepen our penetration of the furniture and bedding market, our growth strategy is increasingly directed to the expansion of our 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 4,450 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% of our worldwide Net sales in 2006 and are our leading product category in growth in recent years. Our mattresses are composed of proprietary multi-layer, heat 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 offerings, The BellaSonna Bed *by* Tempur-Pedic and The SymphonyBed *by* Tempur-Pedic , were introduced at The World Market in Las Vegas in January 2007 and will be shipping to retailers in the first half of 2007. The BellaSonna Bed by Tempur-Pedic combines our proprietary TEMPUR® material with our exclusive T-Flex Support System to create our latest breakthrough in sleep technology. T-Flex features a matrix of individually-adjusting cylinders made from a new form of latex.

Internationally, we will launch several new mattress offerings in many of our markets, including the TEMPUR Scandinavian Supreme , which includes three distinct mattress models and was introduced at European trade shows in January 2007.

Pillows

Our premium pillow offerings include a variety of styles and represented 13% of worldwide Net sales in 2006 and provide plush and pressure-relieving comfort as the temperature sensitive material molds to the body. Globally, we will be rolling out new pillow offerings, including our newest U.S. introduction, The RhapsodyPillow *by* Tempur-Pedic , which was also recently introduced at The World Market in Las Vegas.

Other Products

Our other products represented 18% of our worldwide sales in 2006. 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.

Marketing and Sales

We primarily sell at wholesale through three distinct channels and market directly to consumers in the U.S. and the United Kingdom. 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.

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, sleep shops, specialty back and gift stores, home stores and international department stores.

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.

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 in order to improve patient comfort and wellness.

Third Party

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 60 countries.

Effective January 1, 2007, we completed the purchase of our former Austrian third party distributor, Du Hane Gmbh, for an initial investment of approximately $1.1 million in cash. Upon acquisition, Du Hane GmbH was renamed Tempur Osterreich GmbH, and is now a wholly-owned subsidiary. This acquisition increases our capabilities to expand our market presence through an established sales company in Austria. During 2006, as a third party distributor Austria contributed $3.5 million to our Net sales.

A graphic depiction of our Net sales for the year ended December 31, 2006 is as follows:

Table of Contents

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 and our 540,000 square-foot facility in Duffield, Virginia. Much of the sewing and production of mattress and pillow covers is outsourced to third party suppliers.

In January 2007, we opened a third manufacturing facility located in Albuquerque, New Mexico, for which total construction costs were approximately $100.0 million. This 800,000 square foot state-of-the-art manufacturing plant will meet demand for our products primarily within the western U.S. as well as other third party distributors in North and South America.

Suppliers

We currently 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.

During 2006 we were negatively impacted by a rise in certain raw material prices and fuel surcharges for the transportation and delivery of our products. We have taken steps to mitigate a portion of the impact of price increases through improved productivity and efficiency initiatives.

Research and Development

In the third quarter of 2006 we began expansion of our research and development center located in Duffield, Virginia. As of December 31, 2006 we had spent $1.8 million on the new center and expect to spend a total of $2.5 million on the project which is expected to be completed in 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 $3.7 million, $2.7 million and $2.3 million in 2006, 2005 and 2004, respectively. In 2007, 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.

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.

Table of Contents

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, 2006, we had 14 issued U.S. patents, expiring at various points between 2020 and 2025, and 16 U.S. patent applications pending. We also held 49 foreign patents and had 35 foreign patent applications pending.

As of December 31, 2006, we held approximately 330 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 trademarks, including The CelebrityBed *by* Tempur-Pedic and our other key product models, Swedish Sleep System® and Tempur-Med®, and our Tempur-Pedic logo is registered. 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 recently voted in favor of a new federal fire-resistant standard for mattresses that mirrors the standard set forth in California Technical Bulletin 603. 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.

Employees

As of December 31, 2006, we have approximately 1,300 employees, with approximately 600 in the U.S., 300 in Denmark and 400 in the rest of the world. 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.

Table of Contents

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	59	President and Chief Executive Officer
Matthew D. Clift	47	Executive Vice President of Global Operations
David Montgomery	46	Executive Vice President and President of International Operations
Rick Anderson	47	Executive Vice President and President, North America
Dale E. Williams	44	Senior Vice President, Chief Financial Officer, and Secretary
Bhaskar Rao	41	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.

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 Superieure de Commerce de Reims, France and Middlesex Polytechnic, London.

Rick 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 Proctor & 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 his B.S. and M.B.A. degrees from Virginia Tech.

Table of Contents

Dale E. Williams joined Tempur-Pedic International in July 2003 and serves as Senior 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, when the Louisville, Kentucky office was acquired by Ernst & Young. 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, 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 be required 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:

- 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 currently sold in approximately 6,050 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 our long-term target of 7,000 to 8,000 furniture and bedding stores in the United States, our sales growth will increasingly depend on our ability to generate additional sales in our existing accounts in this channel. If we are unable to increase product sales in our existing retail accounts at a sufficient rate, our Net sales growth will 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 as our Domestic Retail sales channel continues to grow as a percentage of our overall Net sales.

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 change, with 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.

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;
- determine the appropriate creative message and media mix for future advertising expenditures;
- effectively manage advertising costs, including creative and media, to maintain acceptable costs per inquiry, costs per order and operating margins;
- convert inquiries into actual orders; and
- maintain our ability to receive discounted media rates resulting from our direct response advertising model

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 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 on-site, 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 these results could decrease our liquidity and profitability. In addition, we continue to outsource the procurement of certain goods and services from suppliers in foreign countries. If we were no longer able to outsource these suppliers, we could source it elsewhere at a higher cost. To the extent we are unable to pass those higher costs to our customers, these costs could reduce our gross profit margin, 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 or redesign 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% of our Net sales were denominated in foreign currency for the year ended December 31, 2006. 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.

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 2006 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, compliance with changes in fire resistance laws may be costly and could have an adverse impact on the performance of our products. In February 2006, the U.S. Consumer Product Safety Commission issued new rules relating to fire retardancy standards for the mattress and pillow industry. The State of California adopted new fire retardancy standards beginning in 2005. We have 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.

Table of Contents

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, 2006, we had approximately $34.7 million in returns for a return rate of approximately 6% 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 and the potential absence of intellectual property protection, which could impair our ability to compete and our profitability.

We currently conduct international operations in over 70 countries, and we may pursue additional international opportunities. We generated approximately 34% of our Net sales from non-U.S. operations during the year ended December 31, 2006. 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, the potential unavailability of intellectual property protection and labor issues.

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 14 U.S. patents, and we have 16 U.S. patent applications pending. Further, we own 49 foreign patents, and we have 35 foreign patent applications pending. In addition, we hold approximately 330 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.

Although our trademarks are currently registered in the U.S. and registered or pending in 59 foreign jurisdictions, they could be circumvented, or violate the proprietary rights of others, or we could be prevented

Table of Contents

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 it. 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 be issued for our pending patent 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 15% of our Net sales for the year ended December 31, 2006. 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.

In the future, retailers may consolidate, undergo restructurings or reorganizations, 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 all of our products in three manufacturing facilities, and unexpected equipment failures, delays in deliveries, catastrophic loss or construction delays may lead to production curtailments or shutdowns.

We manufacture all of our products at our two facilities in Aarup, Denmark and Duffield, Virginia and recently opened a third facility 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. 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 either 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 harm 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, 2006, we had approximately 1,300 full-time employees, with approximately 600 in the U.S., 300 in Denmark and 400 in the rest of the world. The 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.

Our leverage limits our flexibility and increases our risk of default.

As of December 31, 2006, we had $361.1 million in total Long-term debt outstanding. In addition, as of December 31, 2006, our Stockholders Equity was $213.4 million. Between October 2005 and June 30, 2006, we repurchased a total of $220.0 million in common stock pursuant to a stock repurchase program 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 January 25, 2007, our Board of Directors authorized an additional stock repurchase of up to $100.0 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. We expect that payments of this dividend in 2007 will be approximately $20.0 million. 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 global 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 $3.6 million for each 1% 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.

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;
- 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;
- 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;

Table of Contents

- 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 26, 2007, there were 85.0 million 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 2006, two of our largest stockholders, private equity funds that invested in our Company in 2002 in connection with the acquisition of our predecessor, made several distributions of our common stock to their investors totaling 10.7 million shares and one of these shareholders sold 7.1 million shares. In February 2007, one of these shareholders made an additional distribution of 5.3 million shares. This shareholder continues to hold 4.5 million shares of our common stock and may choose to make additional distributions or sales of our common stock in the future. The other stockholder no longer holds any shares of our common stock. During 2005 these two stockholders also made partial distributions to their investors totaling approximately 18.0 million shares of our common stock.

In addition, on December 24, 2003, we registered up to 14,982,532 shares of our common stock reserved for issuance upon the exercise of options granted or reserved for grant under our 2002 Stock Option Plan, our 2003 Equity Incentive Plan and our 2003 Employee Stock Purchase Plan. Stockholders can sell these shares in the public market upon issuance, subject to restrictions under the securities laws and any applicable lock-up agreements.

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 26, 2007, our executive officers, directors, and their respective affiliates, including our largest stockholder, 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.

Table of Contents

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 over 70 countries and have wholly-owned subsidiaries in 15 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, 2006.

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. Albuquerque, New Mexico	800,000	Leased (until 2035)	Manufacturing
Dan-Foam ApS Aarup, Denmark	517,000	Owned	Manufacturing
Tempur-Pedic, Inc. Lexington, Kentucky	72,000	Leased (until 2009)	Office
Tempur Deutschland GmbH	121,277	Owned	Office and Warehouse

Steinhagen, Germany

In addition to the properties listed above, we have 18 facilities in 12 countries under leases with one to ten year terms. The new 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.

Table of Contents

ITEM 3. LEGAL PROCEEDINGS

Securities Law Action Between October 7, 2005 and November 21, 2005, five complaints were filed against the Company 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 the Company s stock between April 22, 2005 and September 19, 2005, the Securities Law Action . These actions were consolidated and Lead plaintiffs filed a consolidated complaint on February 27, 2006 and asserted claims arising under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Lead plaintiffs allege that certain of the Company 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. Defendants motion to dismiss is due to be filed on March 30, 2007. 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 we 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 we can give no assurance that these claims will not have a material adverse affect on our financial position or results of operations.

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 pending the outcome of the motions to dismiss the defendants in the Securities Law Action. 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. Tempur-Pedic International is in the process of evaluating these claims.

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.). The 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. We strongly believe that the action filed in the Georgia, Rome Division lacks merit, and we intend to defend against the claims vigorously.

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.

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 2006.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND PERFORMANCE GRAPH

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 share, at closing, of our common stock as reported by the NYSE for the fiscal periods indicated.

	High	Low
Fiscal 2005		
First Quarter	$ 21.46	$ 17.73
Second Quarter	$ 24.63	$ 18.57
Third Quarter	$ 23.82	$ 10.98
Fourth Quarter	$ 12.97	$ 9.72
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

As of December 31, 2006, we had approximately 156 shareholders of record of the Company s common stock.

In the first quarter of 2007 the Board of Directors approved an annual cash dividend of $0.24 per share annually, to owners of our common stock. The Board declared a first quarter dividend of $0.06 per share that will be distributed on March 14, 2007 to stockholders of record as of February 27, 2007. This annual cash dividend program may be limited, suspended, or terminated at any time without prior notice. We had never previously declared a cash dividend for our common stock.

Equity Compensation Plan Information

The following table sets forth equity compensation plan information as of December 31, 2006:

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	5,953,903	10.03	4,379,015
Equity compensation plans not approved by security holders	0		0

Total	5,953,903	10.03	4,379,015

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

Table of Contents

Related Stockholder Matters

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 6.8 million 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 11.3 million 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.

On January 25, 2007, our Board of Directors authorized the repurchase of up to $100.0 million of our common stock. Share repurchases under this program 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, deemed appropriate. This share repurchase program may be suspended, limited or terminated at any time without notice. As of February 26, 2007, we have repurchased 0.2 million shares for a total of $6.2 million under this authorization.

Table of Contents

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 three years to the S&P 500 Stock Composite Index and a peer group. We believe in good faith that the selected peer group is an appropriate basis for comparison as it reflects the market in which Tempur-Pedic International competes. 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 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 the 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.

Table of Contents

	12/2003	12/2004	12/2005	12/2006
Tempur-Pedic International Inc.	$ 100.00	136.77	74.19	132.00
S&P 500	100.00	110.88	116.33	134.70
Peer Group	100.00	114.28	94.08	100.85

The peer issuers included in this group are set forth below. In our proxy statement for the 2006 annual meeting of stockholders, we used the same peer group for a comparison in the stock performance graph, which was then labeled as The Hemscott Industry Group Index 311.

Peer Group

Bassett Furniture Ind	Hooker Furniture Corp	Natuzzi Spa Ads
Chromcraft Revington Inc	Hubbell Inc Class A	The Rowe Companies
Color Kinetics Inc	Hubbell Inc Class B	Select Comfort Corp
Empire Global Corp	La-Z-Boy Incorporated	Stanley Furniture Inc
Ethan Alllen Interiors	Leggett & Platt Inc	Tempur-Pedic International Inc
Flexsteel Industries Inc	Lighting Science Group	Xenonics Holdings Inc
Furniture Brands Intl		

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected historical consolidated financial and operating data for the periods indicated. Tempur World, Inc. was formed on January 1, 2000 to combine the manufacturing facilities and the worldwide distribution capabilities of all TEMPUR® products, and our predecessor company for the period from January 1, 2000 to October 31, 2002 is Tempur World, Inc. Tempur-Pedic International was formed in 2002 by TA Associates, Inc. and Friedman Fleischer & Lowe, LLC to acquire Tempur World, Inc., or Tempur World. This acquisition was effective as of November 1, 2002 and is sometimes referred to as the Tempur Acquisition . We completed the Tempur Acquisition (which we accounted for using the purchase method of accounting) as of November 1, 2002. As a result of adjustments to the carrying value of assets and liabilities pursuant to the acquisition, the financial position and results of operations for periods subsequent to the Tempur Acquisition are not comparable to those of our predecessor.

Table of Contents

We have derived our statements of income and balance sheet data as of and for the years ended December 31, 2006, 2005, 2004 and 2003, and for the two months ended December 31, 2002 from our audited financial statements. We have derived the statement of income and balance sheet data as of and for the ten months ended October 31, 2002 from the audited financial statements of our predecessor company. Our financial statements as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006 are included elsewhere in this report.

	Tempur-Pedic International Inc					Predecessor
	2006	2005	2004	2003	Period From November 1, 2002 to December 31, 2002	Period From January 1, 2002 to October 31, 2002
Statement of Income Data:						
Net sales	**$ 945,045**	$ 836,732	$ 684,866	$ 479,135	$ 60,644	$ 237,314
Cost of sales(1)	**484,507**	412,790	323,852	223,865	37,812	110,228
Gross profit	**460,538**	423,942	361,014	255,270	22,832	127,086
Operating expenses(2)	**251,233**	233,327	210,023	157,885	23,825	85,518
Operating income/(loss)	**209,305**	190,615	150,991	97,385	(993)	41,568
Interest expense, net	**(23,920)**	(20,264)	(23,550)	(20,521)	(2,955)	(6,292)
Other income/(expense)(3)	**(10,620)**	(3,879)	(5,254)	(15,662)	1,341	(2,899)
Income/(loss) before income taxes	**174,765**	166,472	122,187	61,202	(2,607)	32,377
Income taxes	**62,443**	67,143	47,180	23,627	640	12,436
Net income/(loss)	**112,322**	99,329	75,007	37,575	(3,247)	19,941
Preferred stock dividend					1,958	1,238
Net income/(loss) available to common stockholders	**$ 112,322**	$ 99,329	$ 75,007	$ 37,575	$ (5,205)	$ 18,703
Balance Sheet Data (at end of period):						
Cash and cash equivalents	**$ 15,788**	$ 17,855	$ 28,368	$ 14,230	$ 12,654	$ 6,380
Restricted cash(4)				60,243		
Total Assets	**725,666**	702,311	639,623	620,349	448,593	199,641
Total senior debt	**312,966**	193,056	192,171	226,522	148,121	88,817
Total debt(5)	**361,132**	344,481	289,671	376,522	198,352	89,050
Redeemable preferred stock						15,331
Total Stockholders Equity	**$ 213,348**	$ 226,329	$ 213,621	$ 122,709	$ 151,606	$ 39,895
Other Financial and Operating Data (GAAP):						
Depreciation and amortization(6)	**$ 28,676**	$ 27,882	$ 28,519	$ 23,975	$ 3,306	$ 10,383
Net cash provided by operating activities	**$ 165,815**	$ 102,249	$ 76,966	$ 46,950	$ 12,385	$ 22,706
Net cash used by investing activities	**$ (37,861)**	$ (86,584)	$ (38,351)	$ (71,107)	$ (1,859)	$ (4,646)
Net cash (used) provided by financing activities	**$ (132,476)**	$ (19,955)	$ (28,507)	$ 26,574	$ (4,221)	$ (19,702)
Diluted earnings (loss) per share	**$ 1.28**	$ .97	$ 0.73	$ 0.39	$ (0.67)	N/A
Capital expenditures	**$ 37,211**	$ 84,881	$ 38,419	$ 32,597	$ 1,961	$ 9,175
Other Financial and Operating Data (non-GAAP):						
Ratio of earnings to fixed charges(7)	**6.6x**	7.9x	5.9x	3.6x		5.1x
Number of pillows sold, net(8)	**2,463,107**	2,535,981	2,896,786	2,751,221		
Number of mattresses sold, net(8)	**774,484**	685,316	547,705	367,189		

(1) Includes $9.8 million in non-cash charges for the two months ended December 31, 2002 relating to the step-up in inventory as of November 1, 2002 relating to the Tempur Acquisition.

(2) Includes $7.9 million, $6.9 million, $9.4 million, and $9.3 million in non-cash charges for the years ended December 31, 2006, 2005, 2004, and 2003, respectively. These amounts are comprised of $4.1 million, $4.0 million, $4.2 million, and $5.1 million in amortization of definite-lived intangibles in 2006, 2005, 2004, and 2003, respectively; and $ 3.8 million, $2.9 million, $5.2 million, and $4.2 million in non-cash stock-based compensation expense relating to restricted stock units, and stock option grants, in 2006, 2005, 2004, and 2003, respectively.

(3) Includes $10.7 million in debt extinguishment charges for the redemption premium and write-off of deferred financing fees related to the redemption of $97.5 million of Senior Subordinated Notes (as defined below) for the year ended December 31, 2006, and $4.2 million in debt extinguishment charges relating to the write-off of deferred financing fees in connection with the Senior Credit Facility refinancing for the year ended December 31, 2005, and $5.4 million in debt extinguishment charges for the redemption premium related to the redemption of $52.5 million of Senior Subordinated Notes for the year ended December 31, 2004. For the year ended December 31, 2003, includes $13.7 million in debt extinguishment charges relating to the write-off of deferred financing fees, the write-off of original issue discount and prepayment penalties in connection with the recapitalization in August 2003.

(4) As of December 31, 2003, we had approximately $60.2 million in restricted cash for the redemption of an aggregate principal amount of $52.5 million of Senior Subordinated Notes, the payment of a redemption premium of approximately $5.4 million and accrued interest expense of approximately $2.4, million which was paid in January 2004.

(5) Includes $52.5 million in aggregate principal amount of Senior Subordinated Notes redeemed on January 23, 2004 for the year ended December 31, 2003.

(6) Includes $ 3.8 million, $2.9 million, $5.2 million, and $4.2 million in non-cash stock-based compensation expense related to restricted stock units, stock option grants, and acceleration in 2006, 2005, 2004, and 2003, respectively

(7) The ratio of earnings to fixed charges for the period from November 1, 2002 to December 31, 2002 is less than one to one. Earnings deficiency for this period is $5.4 million.

(8) Number of units sold, net is after the consideration of returned mattresses and pillows and excludes units shipped to fulfill warranty claims and promotional activities.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with ITEM 6 Selected Financial Data in Part I of this report and the audited consolidated financial statements and accompanying notes thereto included elsewhere in this report. Unless otherwise noted, all of the financial information in this report is consolidated financial information for Tempur-Pedic International Inc. or its predecessor. The forward-looking statements in this discussion regarding the mattress and pillow industries, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements in this discussion are subject to numerous risks and uncertainties. See Special Note Regarding Forward-Looking Statements and ITEM 1A Risk Factors in Part I of this report. Our actual results may differ materially from those contained in any forward-looking statements.

Overview

General We are the leading manufacturer, marketer and distributor of premium mattresses and pillows which we sell globally in over 70 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.

Table of Contents

Business Segment Information We have two reportable business 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 North American third party distributors. 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 operating segment. We evaluate segment performance based on Net sales and Operating income. For the purpose of this Management s Discussion and Analysis of Financial Condition and Results of Operations, our Corporate office operating expenses and certain amounts for goodwill and other assets that are carried at the holding company level are included in the Domestic operating segment.

For a further discussion of factors that could impact operating results, see the section entitled Factors That May Affect Future Performance included within this section and Risk Factors in ITEM 1A, which are incorporated herein by reference.

Strategy and Outlook

Our long-term goal is to become the world s largest bedding company. In order to achieve this goal, we expect to continue to pursue certain key strategies in 2007:

- Maintain our focus on premium mattresses and pillows and to regularly introduce new products.
- Invest in increasing our global brand awareness through targeted marketing and advertising campaigns that further associate our brand name with better overall sleep and premium quality products.
- Extend our presence and improve our account productivity in both the U.S. and International bedding stores.
- Invest in our operating infrastructure to meet the requirements of our growing business, including investments in our research and development capabilities.

Results of Operations

Key financial highlights for 2006 include:

- Our consolidated Net sales rose 13% to $945.0 million in 2006 from $836.7 million in 2005. Retail channel sales worldwide increased 19%. Sales in the Domestic Retail channel grew 22%. Sales in the International Retail channel increased 14%. Our Retail channel continues to be our largest and fastest growing channel and the principal driver of our growth in recent years.
- Worldwide, mattress unit growth increased 13%. Domestic mattress unit growth was particularly robust, increasing 17%. International mattress unit growth was up 7%.
- Our operating income increased $18.7 million or 10% to $209.3 million in 2006. Operating income as a percentage of Net sales was 22% for 2006 and 23% for 2005.
- We repurchased 11.3 million shares of our common stock at a total cost of $144.0 million. These purchases were funded primarily by increased borrowings under our domestic revolving credit facility.

We made voluntary prepayments of $55.9 million on our Foreign term loan, in excess of our scheduled principal payments of $17.2 million, for a total principal reduction of $73.1 million.

We redeemed our 10 $^{1}/4$ Senior Subordinated Notes due 2010 in December 2006, for $97.5 million, resulting in a loss on extinguishment of $10.7 million.

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

(In millions, except earnings per share)	Year Ended December 31, 2006		2005		2004	
Net sales	**$ 945.0**	**100%**	$ 836.7	100%	$ 684.9	100%
Cost of sales	**484.5**	**51**	412.8	49	323.9	47
Gross Profit	**460.5**	**49**	423.9	51	361.0	53
Selling and marketing expenses	**171.8**	**18**	162.8	20	139.0	21
General and administrative and other	**79.4**	**9**	70.5	8	71.0	10
Operating income	**209.3**	**22**	190.6	23	151.0	22
Interest expense, net	**(23.9)**	**(2)**	(20.3)	(2)	(23.5)	(3)
Loss on debt extinguishment	**(10.7)**	**(1)**	(4.2)	(1)	(5.4)	(1)
Other income (expense), net	**0.1**		0.4		0.1	
Income before tax provision	**174.8**	**19**	166.5	20	122.2	18
Income tax provision	**62.5**	**7**	67.2	8	47.2	7
Net Income	**$ 112.3**	**12%**	$ 99.3	12%	$ 75.0	11%
Earnings per share:						
Diluted	**$ 1.28**		$ 0.97		$ 0.73	
Weighted average shares outstanding:						
Diluted	**87.5**		102.1		102.9	

Year Ended December 31, 2006 Compared with Year Ended December 31, 2005

We sell our premium mattresses and pillows through four distribution channels: Retail, Direct, Healthcare, and Third party. The Retail channel sells to furniture and bedding, specialty and department stores. The Direct channel sells directly to consumers. The Healthcare channel sells to hospitals, nursing homes, healthcare professionals and medical retailers. The Third party channel sells to distributors in countries where we do not operate our own wholly-owned subsidiaries. The following table sets forth Net sales information, by channel:

	Consolidated Year Ended December 31,		Domestic Year Ended December 31,		International Year Ended December 31,	
($ in millions)	2006	2005	2006	2005	2006	2005
Retail	**$ 759.8**	$ 639.0	**$ 518.0**	$ 426.0	**$ 241.8**	$ 213.0
Direct	**85.5**	103.2	**75.2**	88.6	**10.3**	14.6
Healthcare	**45.2**	45.9	**12.6**	11.0	**32.6**	34.9
Third Party	**54.5**	48.6	**16.0**	10.7	**38.5**	37.9
	$ 945.0	$ 836.7	**$ 621.8**	$ 536.3	**$ 323.2**	$ 300.4

A summary of Net sales by product is set forth below:

($ in millions)	Consolidated Year Ended December 31, 2006	Consolidated Year Ended December 31, 2005	Domestic Year Ended December 31, 2006	Domestic Year Ended December 31, 2005	International Year Ended December 31, 2006	International Year Ended December 31, 2005
Net sales:						
Mattresses	**$ 651.9**	$ 566.4	**$ 455.7**	$ 392.0	**$ 196.2**	$ 174.4
Pillows	**126.5**	126.2	**60.1**	54.0	**66.4**	72.2
Other	**166.6**	144.1	**106.0**	90.3	**60.6**	53.8
	$ 945.0	$ 836.7	**$ 621.8**	$ 536.3	**$ 323.2**	$ 300.4
Net units sold:						
Mattresses	**774,484**	685,316	**450,433**	383,663	**324,051**	301,653
Pillows	**2,463,107**	2,535,981	**1,192,423**	1,100,725	**1,270,684**	1,435,256

Net sales. Net sales for the year ended December 31, 2006 increased to $945.0 million from $836.7, an increase of $108.3 million, or 13%. This increase in Net sales was primarily attributable to the continued progress on several of the key initiatives we put in place to accelerate growth, expand market share, and improve retail account productivity. During 2006, Net sales growth attributable to foreign currency exchange rate fluctuation was $2.1 million, which represented less than 1% of Net sales. The Retail channel increased $120.8 million, or 19% in 2006. The growth in our Retail channel reflects our focus on targeted penetration of furniture and bedding retail stores in both our Domestic and International markets. We also added new product offerings to our existing line in both our Domestic and International markets in 2006. Our Third party channel increased 12% while the Direct and Healthcare channels decreased 17%, and 2%, respectively. The increase in our Third party channel was primarily due to growth in our Canadian and other third party distributors in our Domestic segment.

Domestic. Domestic Net sales for the year ended December 31, 2006 increased to $621.8 million from $536.3 million for the same period in 2005, an increase of $85.5 million, or 16%. Our Domestic Retail channel delivered $518.0 million in Net sales for 2006. This is an increase of $92.0 million, or 22% over the prior year. The increase represents progress on several of the key initiatives we put in place to accelerate growth. We have improved account productivity by increasing sales and average slots per store in our Retail channel in both established and new accounts, expanded our Retail sales force and introduced new products. In 2006, we introduced two new mattress products, The GrandBed *by* Tempur-Pedic™ and The RhapsodyBed *by* Tempur-Pedic™. Consistent with prior years, in 2006 increasing distribution into new stores, including the addition of several new large Retail accounts, was a driver to our sales growth. As of December 31, 2006, our products were sold in approximately 6,050 furniture and bedding retail stores in the U.S., out of a total of approximately 10,000 stores we have targeted. We expect to enter between 7,000 and 8,000 of these stores over time. As we approach our store target, our growth strategy will increasingly be directed to the expansion of our business within our established accounts. Our Third party channel increased 50% due to our continued market share growth in Canada and in certain Central and South American countries. Our Direct channel decreased 15% primarily as a result of our Retail channel expansion. Healthcare increased $1.6 million, or 15%, as a result of our successful arrangements with leading industry distributors. Domestic mattress sales in 2006 increased $63.7 million, or 16%, over the same period in 2005 and pillow sales increased $6.1 million, or 11%.

International. International Net sales for the year ended December 31, 2006 increased to $323.2 million from $300.4 million for the same period in 2005, an increase of $22.8 million, or 8%. The International Retail channel Net sales increased $28.8 million, or 14%, for the year ended December 31, 2006. Net sales in our Third party channel increased $0.6 million, an increase of 2%. Our Direct and Healthcare channels had Net sales decreases of 29% and 7%, respectively. The growth in Retail sales is due to the addition of new stores to the channel and improved productivity of existing accounts. The decrease in our Direct channel is primarily related to the decision to change our Direct sales operation in several European markets in favor of a modified version of the program that directs potential customers to our Retail channel. Our Healthcare channel decreased primarily due to changes in certain countries government reimbursement policies. International mattress sales increased $21.8 million, or 13%, for 2006 and pillow sales decreased $5.8 million, or 8%, as compared to 2005.

Gross profit. Gross profit for the year ended December 31, 2006 increased to $460.5 million from $423.9 million for the same period in 2005, an increase of $36.6 million, or 9%. Gross margin for the year ended December 31, 2006 was 49%, as compared to 51% in the same period of 2005. Our margins were negatively impacted by several factors during the year ended December 31, 2006. First, our margins were impacted by the growth in our Retail channel because sales in our Retail channel are generally at wholesale prices. Second, our overall product mix has shifted to mattress and other products. Our mattresses generally carry lower margins than our pillows and are sold with lower margin products such as foundations and bed frames. Third, our gross margin was negatively impacted by discounted floor models. Finally, increases in raw material costs impacted our gross margin particularly in the first half of 2006. However, our productivity and sourcing initiatives largely offset the impact of these cost increases.

While there have been margin pressures due to product and channel mix and other factors, we have made improvements in several areas of our operations which have helped to offset these declines. Yields have increased substantially at our manufacturing facilities, and we have achieved cost savings through our sourcing and distribution initiatives. We anticipate gross margin to be slightly down for the full year 2007 as a result of the ramp-up of our new facility in New Mexico, as well as some minor impact related to channel and product mix; however, we feel that the decrease in our gross margins will be moderated by the continuation of our productivity initiatives.

Domestic. Domestic Gross profit for the year ended December 31, 2006 increased to $274.8 million from $240.7 million, an increase of $34.1 million, or 14%. The Gross profit margin in our Domestic segment was 44% and 45% for 2006 and 2005, respectively. For the year ended December 31, 2006, the Gross profit margin for the Domestic segment was impacted by the increase in our Retail channel sales and the discounting of floor models related to the introduction of new and refreshed mattress products and the addition of new Retail customers. These factors were offset by our ongoing productivity and global sourcing initiatives. Our Domestic Cost of sales increased to $347.0 million for the year ended December 31, 2006 as compared to $295.6 million for the year ended December 31, 2005, an increase of $51.4 million, or 17%.

International. International Gross profit for the year ended December 31, 2006 increased to $185.7 million from $183.2 million, an increase of $2.5 million, or 1%. The Gross profit margin in our International segment was 57% and 61% for 2006 and 2005, respectively. For the year ended December 31, 2006, the Gross profit margin for the International segment was impacted by continued Retail channel growth. During 2006, the International segment no longer shipped mattress units to the U.S., creating a decrease in International production capacity efficiencies. Product and geographic mix have adversely impacted our gross margins in this segment as pillow sales in Japan and to certain third party distributors have declined. Our International Cost of sales increased to $137.5 million for the year ended December 31, 2006, as compared to $117.2 million for the year ended December 31, 2005, an increase of $20.3 million, or 17%.

Selling and marketing expenses. Selling and marketing expenses include advertising and media production associated with our Direct channel, other marketing materials such as catalogs, brochures, videos, product samples, direct customer mailings and point of purchase materials, and sales force compensation and customer service. We also include in Selling and marketing expenses certain new product development costs, including market research and testing for new products. Selling and marketing expenses increased to $171.8 million for the year ended December 31, 2006 as compared to $162.8 million for the year ended December 31, 2005, an increase of $9.0 million, or 1%. Selling and marketing expenses as a percentage of Net sales decreased to 18% during 2006 from 19% for 2005. For the year ended December 31, 2006, we recognized $0.4 million of compensation expense in selling and marketing expenses associated with the adoption of SFAS 123R, Accounting for Stock Based Compensation (SFAS 123R). Both total Selling and marketing expenses and advertising spending decreased as a percentage of Net sales. Our objective is to increase our advertising spending at the same rate as

Table of Contents

our revenue growth. However, in the third and fourth quarters of 2006, our advertising spending decreased. This decrease is attributable to the record campaign spending for the mid-term elections and its impact on available TV advertising space. Our Retail channel has lower selling expenses than our other channels on a combined basis and, accordingly, our Selling and marketing expenses as a percentage of our Net sales are affected by the level of our Retail sales as a percentage of our Net sales.

General and administrative and other. General and administrative and other expenses include management salaries, information technology, professional fees, depreciation of furniture and fixtures, leasehold improvements and computer equipment, expenses for finance, accounting, human resources and other administrative functions, and research and development costs associated with our new product developments. General and administrative and other expenses increased to $79.4 million for the year ended December 31, 2006 as compared to $70.5 million for the year ended December 31, 2005, an increase of $8.9 million, or 13%. The increase was primarily attributable to increased investment in our information technology infrastructure, professional services, share based compensation expense related to the adoption of SFAS 123R, and research and development. For the year ended December 31, 2006, we recognized $1.9 million of compensation expense in general and administrative associated with the adoption of SFAS 123R. General and administrative and other expenses as a percentage of Net sales remained relatively flat for the year ended December 31, 2006 compared to the same period in 2005.

Interest expense, net. Interest expense, net includes the interest costs associated with our borrowings and the amortization of deferred financing costs related to those borrowings. Interest expense, net, increased to $23.9 million for the year ended December 31, 2006 as compared to $20.3 million for the year ended December 31, 2005, a increase of $3.6 million, or 18%. This increase in interest expense is primarily attributable to higher Long-term debt levels that are directly related to our share repurchase program. During 2006 we also capitalized interest costs of $5.1 million related to the construction of our new manufacturing facility which offset our increased interest expenses.

Loss on debt extinguishment. Loss on debt extinguishment for the year ended December 31, 2006 was $10.7 million. Of that loss, $7.6 million relates to the early retirement premium associated with the full redemption of our 2003 Senior Subordinated Notes in December 2006 and non-cash write-off of $3.1 million in deferred financing charges. Loss on debt extinguishment for the year ended December 31, 2005 was $4.2 million and relates to recapitalization of our Senior Secured Credit Facility (as defined below).

Income tax provision. Our Income tax provision includes income taxes associated with taxes currently payable and deferred taxes, and it includes the impact of net operating losses for certain of our domestic and foreign operations. For the year ended December 31, 2006, our Income tax provision also includes a benefit of $3.1 million related to a favorable foreign tax ruling affecting certain tax reserves. Our effective income tax rate for the year ended December 31, 2006 differed from the federal statutory rate principally because of the benefit from the elimination of certain tax reserves, certain foreign tax rate differentials, state and local income taxes, valuation allowances on certain foreign net operating losses, and compensation expense associated with certain stock options granted prior to the initial public offering. Our effective income tax rate for the year ended December 31, 2005 differed from the federal statutory rate principally because of the effect of the charge for the foreign repatriation, the benefit from a favorable state tax ruling, certain foreign tax rate differentials, state and local income taxes, valuation allowances on certain foreign net operating losses, and compensation expense associated with certain stock options granted prior to the initial public offering.

Our effective tax rate for the year ended December 31, 2006 was 35.7%. Excluding the impact of the tax reserve benefit described above, our effective tax rate would have been 37.5% for the year ended December 31, 2006. For the same period in 2005, the effective tax rate was 40.3%. Excluding the effects of the foreign repatriation and favorable state tax ruling our effective rate would have been 37.3% for the year ended December 31, 2005.

Table of Contents

Year Ended December 31, 2005 Compared with Year Ended December 31, 2004

The following table sets forth Net sales information, by channel:

	Consolidated Year Ended December 31,		Domestic Year Ended December 31,		International Year Ended December 31,	
($ in millions)	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**
Retail	**$ 639.0**	$ 489.5	**$ 426.0**	$ 327.1	**$ 213.0**	$ 162.4
Direct	**103.2**	99.7	**88.6**	84.2	**14.6**	15.5
Healthcare	**45.9**	46.6	**11.0**	11.5	**34.9**	35.1
Third Party	**48.6**	49.1	**10.7**	8.0	**37.9**	41.1
	$ 836.7	$ 684.9	**$ 536.3**	$ 430.8	**$ 300.4**	$ 254.1

A summary of Net sales by product is set forth below:

	Consolidated Year Ended December 31,		Domestic Year Ended December 31,		International Year Ended December 31,	
($ in millions)	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**
Net sales:						
Mattresses	**$ 566.4**	$ 433.3	**$ 392.0**	$ 302.5	**$ 174.4**	$ 130.8
Pillows	**126.2**	138.0	**54.0**	54.4	**72.2**	83.6
Other	**144.1**	113.6	**90.3**	73.9	**53.8**	39.7
	$ 836.7	$ 684.9	**$ 536.3**	$ 430.8	**$ 300.4**	$ 254.1
Units sold:						
Mattresses	**685,316**	547,705	**383,663**	323,444	**301,653**	224,261
Pillows	**2,535,981**	2,896,786	**1,100,725**	1,117,640	**1,435,256**	1,779,146

Net sales. Net sales for the year ended December 31, 2005 increased to $836.7 million from $684.9 million, an increase of $151.8 million, or 22%. This increase in Net sales was primarily attributable to the continued execution of our core strategy of investing to build our global brand awareness and penetrating existing channels. During 2005, Net sales growth attributable to foreign currency exchange rate fluctuation was $1.9 million, which represented less than 1% of Net sales. The Retail channel increased $149.5 million, or 31% in 2005. Additionally, we added new product offerings to our existing line in both our Domestic and International markets in 2005. Our Direct channel increased 4% while the Healthcare and Third party channels decreased 2%, and 1%, respectively. The decrease in our Third party channel was primarily due to weakness in our International pillow business, mainly in Japan. Consolidated pillow sales decreased approximately $11.8 million from 2004.

Although our Net sales rose 22% for the year ended December 31, 2005, our sales growth slowed considerably during 2005, with Net sales in the fourth quarter of 2005 increasing 9% as compared to the fourth quarter of 2004. Our growth rate in the last half of 2005 was adversely impacted by a number of factors. We experienced weaker than expected demand from our specialty retail channel for pillows and mattresses. In addition, we opened or expanded distribution in several large Domestic accounts later in the year than we had originally expected, which impacted our level of sell through. We launched several initiatives to accelerate Domestic sales growth and otherwise strengthen our business in 2006. These initiatives included expanding our retail sales force in both the U.S. and internationally and increasing our marketing investment around the world to continue building our brand awareness.

Domestic. Domestic Net sales for the year ended December 31, 2005 increased to $536.3 million from $430.8 million for the same period in 2004, an increase of $105.5 million, or 24%. Our Domestic Retail channel continued to be our largest channel, with $426.0 million in Net sales for 2005. This is an increase of $98.9 million, or 30% over the prior year. This increase was primarily a result of our expanded distribution for our

Table of Contents

products into additional retail furniture and bedding stores. In 2005, we added approximately 1,210 retail furniture and bedding doors and introduced two new mattress products, The EuroBed *by* Tempur-Pedic™ and The OriginalBed *by* Tempur-Pedic™. Our Third Party channel increased 34% due to the continued focus on expanding our distribution network in North, Central and South America. Our Direct channel grew 5%, while our Healthcare channel decreased 4%. Domestic mattress sales in 2005 increased $89.5 million, or 30%, over the same period in 2004. Pillow sales decreased $0.4 million, or 1%. During 2004, pillow sales were positively impacted by the launch of a new pillow line with one of our largest Retail channel customers. While we launched a new pillow product in 2005 with the same customer, we did not receive the same positive market response as we did in 2004.

International. International Net sales for the year ended December 31, 2005 increased to $300.4 million from $254.1 million for the same period in 2004, an increase of $46.3 million, or 18%. The largest channel in our International segment continued to be our Retail channel, which increased $50.6 million, or 31%, for the year ended December 31, 2005. The growth in Retail sales is due to the addition of new stores to the channel and successful new product launches during the year. We added approximately 800 furniture retail and department store doors in 2005 and increased distribution of our Scandinavian Bed Collection in Europe which was previously only available in the Nordic region. Our Direct, Healthcare, and Third party channels had sales decreases of 6%, 1%, and 8%, respectively. The decrease in our Direct channel was primarily related to the decision to change our Direct sales operation in several European markets in favor of a modified version of the program that directs potential customers to furniture retail and department stores that sell our products. Our Healthcare channel decreased primarily due to changes in certain countries government reimbursement policies. Our Third Party channel decreased due to strategic changes in our International Third Party channel in Asia that we implemented in order to protect our subsidiary distribution in the region. International mattress sales increased $43.6 million, or 33%, for 2005. Pillow sales decreased $11.4 million, or 14%, as compared to 2004.

Gross profit. Gross profit for the year ended December 31, 2005 increased to $423.9 million from $361.0 million for the same period in 2004, an increase of $62.9 million, or 17%. Our margins were impacted by the relative rate of growth in our Retail channel. Sales in our Retail channel are generally at wholesale prices. The overall shift in our product mix to mattresses was also a factor because our mattresses generally carry lower margins than our pillows. Our margins were also impacted by changes in our manufacturing capacity, which affected utilization.

Increases in shipping costs reduced our margins in 2005. We began importing several mattress models from Europe in the first quarter of 2005, and we continued importing through the end of the third quarter in order to build the necessary stock levels of the EuroBed that was introduced to the U.S. during the year. Therefore, we incurred additional freight costs to bring this inventory from Europe. As a result of sales in the U.S. growing at a slower rate than expected, increased productivity at our U.S. manufacturing facility and the new capability to make EuroBed mattresses in our U.S. manufacturing facility, we no longer imported mattresses from Denmark. Increases in raw materials costs also reduced our margin.

Domestic. Domestic Gross profit for the year ended December 31, 2005 increased to $240.7 million from $211.7 million, an increase of $29.0 million, or 14%. The Gross profit margin in our Domestic segment was 45% and 49% for 2005 and 2004, respectively. For the year ended December 31, 2005, the Gross profit margin for the Domestic segment was impacted by the increase in our Retail channel sales, the increased freight costs of importing products from our Danish manufacturing facility, and increases in raw materials costs. In addition, during the third quarter, we simultaneously introduced the EuroBed and the OriginalBed and succeeded in placing these products with a large number of retailers. However, as part of this rollout process, we discounted showroom floor models for retail accounts and this negatively impacted our gross profit margins. We completed the majority of these rollouts during 2005. Our Domestic Cost of sales increased to $295.6 million for the year ended December 31, 2005 as compared to $219.1 million for the year ended December 31, 2004, an increase of $76.5 million, or 35%.

International. International Gross profit for the year ended December 31, 2005 increased to $183.2 million from $149.3 million, an increase of $33.9 million, or 23%. The Gross profit margin in our International segment was 61% and 59% for 2005 and 2004, respectively. For the year ended December 31, 2005, the Gross profit margin for the International segment was impacted by product and geographic mix. Also, increased levels of production to satisfy U.S. demand improved the level of manufacturing capacity utilization. Our International Cost of sales increased to $117.2 million for the year ended December 31, 2005, as compared to $104.8 million for the year ended December 31, 2004, an increase of $12.4 million, or 12%.

Selling and marketing expenses. Selling and marketing expenses increased to $162.8 million for the year ended December 31, 2005 as compared to $139.0 million for the year ended December 31, 2004, an increase of $23.8 million, or 17%. The increase in Selling and marketing expenses was due to additional spending on advertising, sales compensation and point of purchase materials. Selling and marketing expenses as a percentage of Net sales decreased to 20% during 2005 from 21% for 2004. The decrease was due primarily to the increase in the Net sales of our Retail channel.

General and administrative and other. General and administrative and other expenses decreased to $70.5 million for the year ended December 31, 2005 as compared to $71.0 million for the year ended December 31, 2004, a decrease of $0.5 million, or 1%. While costs such as depreciation, salary expenses and property and franchise taxes increased in connection with our continued growth, other costs such as stock-based compensation and compliance with the Sarbanes-Oxley Act of 2002 requirements decreased. General and administrative and other expenses as a percentage of Net sales were 8% and 10% for the years ended December 31, 2005 and December 31, 2004, respectively. The decrease as a percentage of sales was due to increased operating leverage from fixed administrative costs. Additionally, the costs of complying with the Sarbanes-Oxley Act of 2002 requirements were substantially less than the prior year, when we incurred the costs of first year compliance.

Interest expense, net. Interest expense, net includes the interest costs associated with our borrowings and the amortization of deferred financing costs related to those borrowings. Interest expense, net, decreased to $20.3 million for the year ended December 31, 2005 as compared to $23.5 million for the year ended December 31, 2004, a decrease of $3.2 million, or 14%. This decrease in interest expense is attributable to lower average debt levels in 2005 and capitalized interest costs of $2.6 million for the year ended December 31, 2005 related to the construction of our new manufacturing facility.

Loss on debt extinguishment. Loss on debt extinguishment for the year ended December 31, 2005 was $4.2 million. Of that loss, $0.7 million relates to the write-off of deferred financing fees associated with the European Term A Loan, which was prepaid on March 31, 2005. In the fourth quarter of 2005, we also incurred non-cash write-off of $3.5 million related to deferred financing charges from our prior secured senior credit facility. Loss on debt extinguishment for the year ended December 31, 2004 was $5.4 million and relates to our redemption in January 2004 of $52.5 million aggregate principal amount of the outstanding Senior Subordinated Notes.

Income tax provision. Our Income tax provision includes income taxes associated with taxes currently payable and deferred taxes, and it includes the impact of net operating losses for certain of our domestic and foreign operations. For the year ended December 31, 2005, our Income tax provision also included an expense of $6.6 million related to the repatriation of foreign earnings under the provisions of the Jobs Creation Act of 2004 and a benefit of $1.6 million related to a favorable state tax ruling. Our effective income tax rates for the year ended December 31, 2005 and for the year ended December 31, 2004 differed from the federal statutory rate principally because of the effect of the charge for the repatriation in 2005, the benefit from the favorable state tax ruling in 2005, certain foreign tax rate differentials, state and local income taxes, valuation allowances on certain foreign net operating losses, and compensation expense associated with certain options granted prior to the initial public offering.

Our effective tax rate for the year ended December 31, 2005 was 40.3%. Excluding the impact of the transactions and adjustments described above, our effective tax rate would have been 37.3% for the year ended December 31, 2005. For the same period in 2004, the effective tax rate was 38.6%.

Table of Contents

Liquidity and Capital Resources

Liquidity

Our principal sources of funds are cash flows from operations and borrowings. Our principal uses of funds consist of capital expenditures, payments of principal and interest on our debt facilities, and share repurchases made from time to time pursuant to a share repurchase program. At December 31, 2006, we had working capital of $105.8 million including Cash and cash equivalents of $15.8 million as compared to working capital of $107.3 million including $17.9 million in Cash and cash equivalents as of December 31, 2005. Working capital remained relatively flat for the year ended December 31, 2006 compared to the same period in 2005.

Our cash flow from operations increased to $165.8 million for the year ended December 31, 2006 as compared to $102.2 million for the year ended December 31, 2005. The increase in operating cash flows was primarily related to our efforts to improve our cash cycle. Decreases in our inventory levels provided an increase in operating cash flows of $39.7 million for the year ended December 31, 2006 as compared to the same period in 2005. Net income for the year ended December 31, 2006 increased $13.0 million compared to the year ended December 31, 2005.

Net cash used in investing activities decreased to $37.9 million for the year ended December 31, 2006 as compared to $86.6 million for the year ended December 31, 2005, a decrease of $48.7 million. Investing activities in the year ended December 31, 2006 consisted primarily of $19.4 million related to the construction of our new manufacturing facility in New Mexico, as compared to $73.0 million for the year ended December 31, 2005.

Cash flow used by financing activities was $132.5 million for the year ended December 31, 2006 as compared to $20.0 million for the year ended December 31, 2005, representing an increase in cash flow used of $112.5 million. The increase was primarily due to $144 million in repurchases of our common stock. In addition we redeemed $97.5 million of our Senior Subordinated Notes and made payments totaling $73.1 million on our Foreign Term Loan, both of which were funded by borrowings under our 2005 Senior Credit Facility. Our financing activities were also impacted by $7.7 million in excess tax benefits of stock based compensation resulting from the adoption of SFAS 123R.

Capital Expenditures

Capital expenditures totaled $37.2 million for year ended December 31, 2006, including $5.2 million in capitalized interest costs related to the construction of our new manufacturing facility discussed below. Capital expenditures totaled $84.9 million for the year ended December 31, 2005. We currently expect our 2007 capital expenditures to be approximately $20.0 million. As of December 31, 2006, we had capital commitments of $0.8 million.

In order to meet anticipated future demands for our products, we built a third manufacturing facility in Albuquerque, New Mexico. Construction on this facility began in September 2004 and was completed in the fourth quarter of 2006. We successfully completed qualifying and testing on our new facility during the fourth quarter of 2006. In January 2007, we began mattress production. Our total capital expenditures related to this facility were approximately $100.0 million. This facility will allow us to meet the demands for our products primarily in the western U.S. as well as certain third party distributors.

In 2004, we completed expansions of both our other manufacturing facilities. Our Danish facility expansion cost approximately $18.4 million, and our Duffield, Virginia facility expansion cost approximately $21.0 million. The additional production capacity at our U.S. manufacturing facility in Duffield allowed us to significantly increase our mattress manufacturing capacity. The expansion at our Danish facility allowed us to meet the demands for our International operations.

Table of Contents

Debt Service

Secured Credit Financing. On October 18, 2005, we entered into a credit agreement with a syndicate of banks (2005 Senior Credit Facility). We used proceeds from the 2005 Senior Credit Facility to pay off amounts under our prior senior credit facility and an unsecured revolving credit facility, among other things. The prior senior credit facility was terminated upon repayment. On February 8, 2006 and on December 13, 2006 we entered into amendments to the 2005 Senior Credit Facility, which increased availability and amended one financial covenant.

The 2005 Senior Credit Facility, as amended, consists of domestic and foreign credit facilities that provide for the incurrence of indebtedness up to an aggregate principal amount of $454 million. The domestic credit facility is a five-year, $324 million revolving credit facility (Domestic Revolver). Availability under the Domestic Revolver is reduced by $3 million each quarter, beginning with the second quarter of 2006. The foreign credit facilities consist of a $20 million revolving credit facility (Foreign Revolver) and $110 million term loan (Foreign Term Loan). The various credit facilities bear interest at a rate equal to the 2005 Senior Credit Facility s applicable margin, as determined in accordance with a performance pricing grid set forth in the 2005 Senior Credit Facility, plus one of the following indexes: LIBOR and for U.S. dollar-denominated loans only, a base rate. The base rate for the U.S. dollar-denominated loans is defined as the higher of either the Bank of America prime rate or the Federal Funds rate plus .50%. We also pay an annual facility fee on the total amount of the 2005 Senior Credit Facility. The facility fee is calculated based on the consolidated leverage ratio and ranges from .175% to .35%.

The 2005 Senior Credit Facility is guaranteed by Tempur-Pedic International Inc., Tempur World, LLC and Tempur World Holdings, LLC, as well as certain other of our subsidiaries, and is secured by certain fixed and intangible assets of Dan Foam ApS and substantially all U.S. assets. The maturity date of the 2005 Senior Credit Facility is October 18, 2010. The 2005 Senior Credit Facility contains certain financial covenants and requirements affecting us, among the most significant of which are a fixed charge coverage ratio requirement and a consolidated leverage ratio requirement. We were in compliance with all covenants as of December 31, 2006.

On February 8, 2006, we entered into an amendment to our 2005 Senior Credit Facility, with certain of our subsidiaries and a syndicate of banks. The amendment, among other things: increased the amount available under the 2005 Senior Credit Facility s Domestic Revolver from $200 million to $260 million; decreased the amount available under the 2005 Senior Credit Facility s Foreign Revolver from $30 million to $20 million, and amended and restated the covenant in the 2005 Senior Credit Facility addressing maintenance of a minimum Consolidated Fixed Charge Coverage Ratio (as defined in the 2005 Senior Credit Facility) to make the covenant less restrictive.

On December 13, 2006, we entered into another amendment to the 2005 Senior Credit Facility, with certain of our subsidiaries and a syndicate of banks. The amendment, among other things: increased the amount available under the 2005 Senior Credit Facility s Domestic Revolver from $254 million to $324 million, amended the definition of Consolidated Fixed Charges (as defined in the 2005 Senior Credit Facility) and provided for the Company s ability to increase the Domestic Revolver by an additional $50 million at the discretion of the Company. On February 22, 2007, we exercised this option to increase the Domestic Revolver.

At December 31, 2006, we had a total of $344 million of long-term revolving credit facilities under the 2005 Senior Credit Facility, which was comprised of the $324 million Domestic Revolver and the $20 million Foreign Revolver, referred to collectively as the Revolvers. The Revolvers provide for the issuance of letters of credit which, when issued, constitute usage and reduce availability under the Revolvers. The aggregate amount of letters of credit outstanding under the Revolvers was $52 million at December 31, 2006. After giving effect to letters of credit and $253.5 million in borrowings under the Domestic Revolver, the $14.7 million under the Foreign Revolver and the quarterly reduction in the Domestic Revolver, total availability under the Revolvers was $25.8 as of December 31, 2006.

Table of Contents

Industrial Revenue Bonds. On October 27, 2005, Tempur Production USA, Inc., one of our subsidiaries completed an industrial revenue bond financing for the construction and equipping of our new manufacturing facility (the Project) located in Bernalillo County, New Mexico. Under the terms of the financing, Bernalillo County will issue up to $75 million of Series 2005A Taxable Variable Rate Industrial Revenue Bonds (the Series A Bonds). The Series A Bonds will be marketed to third parties by a remarketing agent and secured by a letter of credit issued under our Domestic Revolver and purchased by qualified investors. The Series A Bonds have a final maturity date of September 1, 2030. The interest rate on the Series A Bonds is a weekly rate set by the remarketing agent, in its sole discretion, though the interest rate may not exceed the lesser of the highest rate allowed under New Mexico law or 12% per annum. On October 27, 2005, Tempur Production USA, Inc made an initial draw of $53.9 million on the Series A Bonds. We used proceeds from the Series A Bonds to pay down the prior domestic revolving credit facility, among other things. We expect to complete our last draw on the Series A Bonds during 2007.

Bernalillo County will also issue up to $25.0 million of Series 2005B Taxable Fixed Rate Industrial Revenue Bonds. The Series B Bonds will be sold to Tempur World LLC, will not be secured by the letter of credit described above, and will be held by Tempur World, LLC, representing our equity in the Project. The Series B Bonds have a final maturity date of September 1, 2035. The interest rate on the Series B Bonds is fixed at 7.75%. On October 27, 2005, we made an initial draw of $18.0 million under the Series B Bonds, which was transferred to and used by Tempur World LLC to purchase Series B Bonds.

On October 27, 2005, Tempur Production USA, Inc. transferred its interest in the Project to Bernalillo County, and Bernalillo County leased the Project back to Tempur Production USA, Inc. on a long-term basis with the right to purchase the Project for one dollar when the Series A and Series B Bonds, (the Bonds), are retired. Pursuant to the lease agreement, Tempur Production USA, Inc. will pay rent to Bernalillo County in an amount sufficient to pay debt service on the Bonds and certain fees and expenses. The Bonds are not general obligations of Bernalillo County, but are special, limited obligations payable solely from bond proceeds, rent paid by Tempur Production USA, Inc. under the lease agreement, and other revenues. The substance of the transaction is that Bernalillo County issued the Bonds on behalf of Tempur Production USA, Inc. Therefore, we have recorded the obligation as long-term debt of $53.9 million in our consolidated balance sheet as of the date of the transaction.

Senior Subordinated Notes. In 2003, we issued an aggregate principal amount of $150 million of 10.25% Senior Subordinated Notes due 2010 (Senior Subordinated Notes).

On January 23, 2004, we redeemed an aggregate principal amount of $52.5 million of outstanding Senior Subordinated Notes. The redemption price was 110.25% of the principal amount plus accrued interest, and the redemption was funded with a portion of the net proceeds from the initial public offering of Tempur-Pedic International Inc. We reflected the $5.4 million redemption premium as a Loss on extinguishment of debt included in Other income (expense), net in the year ended December 31, 2004.

On December 29, 2006, we redeemed in full the outstanding aggregate principal amount of $97.5 million of Senior Subordinated Notes. The redemption price was 107.815% of the principal amount. We reflected the $7.6 million redemption premium and the $3 million related to the non-cash write-off of deferred financing fees as a Loss on extinguishment of debt included in Other income (expense), net in the year ended December 31, 2006.

Stockholders Equity

Initial Public Offering. In December 2003, we raised $87.5 million from the initial public offering of 6.3 million shares of common stock at a price to the public of $14.00 per share, all of which shares were issued and sold by us. Net proceeds, after deducting underwriting discounts and commissions, of $79.0 million were received by us and invested in short-term, investment-grade, interest-bearing instruments. In connection with the initial public offering, certain of our stockholders also sold 15.3 million shares of common stock, including

2.8 million shares pursuant to the underwriters exercise in full of their over-allotment option, for net proceeds of $200.4 million. We did not receive any proceeds from the sale of shares by the selling stockholders. We used a portion of the proceeds from the initial public offering to redeem $52.5 million of Senior Subordinated Notes and to repay approximately $18.7 million of indebtedness under our 2003 Senior Credit Facility. In conjunction with the January 23, 2004 redemption of the Senior Subordinated Notes, we reflected the $5.4 million redemption premium as a Loss on debt extinguishment in the first quarter of 2004. Total offering expenses were approximately $8.6 million.

Secondary Public Offering. On November 23, 2004, Tempur-Pedic International Inc. closed a secondary offering of 15.0 million shares of its common stock, including the subsequent exercise in full of the underwriters overallotment option, at a price of $18.96 per share. All shares were sold by certain of the stockholders pursuant to the terms of a registration rights agreement originally entered into in November 2002 in connection with the acquisition of Tempur World, Inc. We incurred $0.9 million in expenses associated with this offering.

Share Repurchase Program. 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 deemed appropriate. During 2005, we repurchased 6.8 million shares, at a total cost of $76.0 million. We funded these share repurchases from borrowings under the 2005 Senior Credit Facility and funds from operations. 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 Tempur-Pedic International Inc. s common stock. During 2006, we repurchased 11.3 million shares at a total cost of $144.0 million. As of December 31, 2006, we had completed the existing share repurchase authorization. The share repurchases were funded from borrowings under the 2005 Senior Credit Facility and funds from operations.

On January 25, 2007, the Board of Directors authorized the repurchase of up to $100.0 million of common stock. Share repurchases under this program may be made through open market transactions, negotiated purchases or otherwise, at times and in such amounts as we deemed appropriate. This share repurchase program may be suspended, limited or terminated at any time without notice. As of February 26, 2007, we have repurchased 0.2 million shares under this authorization for a total of $6.2 million.

Dividend Program. In the first quarter of 2007, the Board of Directors approved an annual cash dividend of $0.24 per share annually, to be paid in quarterly installments to the owners of our common stock. The Board declared a first quarter dividend of $0.06 per share that will be distributed on March 14, 2007 to stockholders of record as of February 27, 2007. This annual cash dividend program may be limited, suspended, or terminated at any time without prior notice. We had never previously declared a cash dividend for our common stock.

Future Liquidity Sources

Our primary sources of liquidity are cash flow from operations and borrowings under our Revolvers. We expect that ongoing requirements for debt service and capital expenditures will be funded from these sources. As of December 31, 2006, we had $361.1 million in total Long-term debt outstanding, and our Stockholders Equity was $213.4 million. Our debt service obligations could, under certain circumstances, have material consequences to our security holders. Total cash interest payments related to our borrowings are expected to be approximately $21.8 million in 2007.

Based upon the current level of operations and anticipated growth, we believe that cash generated from operations and amounts available under our Revolvers will be adequate to meet our anticipated debt service requirements, capital expenditures, share repurchases, dividend payments and working capital needs for the foreseeable future. There can be no assurance, however, that our business will generate sufficient cash flow from operations or that future borrowings will be available under our 2005 Senior Credit Facility or otherwise to enable us to service our indebtedness or to make anticipated capital expenditures.

Contractual Obligations

Our contractual obligations and other commercial commitments as of December 31, 2006 are summarized below:

Contractual Obligations	Payment Due By Period						
($ in millions)	**2007**	**2008**	**2009**	**2010**	**2011**	**After 2011**	**Total Obligations**
Long-term debt	$ 19.5	$ 19.5	$ 19.4	$ 16.5	$ 276.0	$ 10.2	$ 361.1
Operating leases	4.3	3.7	3.1	2.3	2.1	5.7	21.2
Capital expenditure commitments	0.8						0.8
Total	$ 24.6	$ 23.2	$ 22.5	$ 18.8	$ 278.1	$ 15.9	$ 383.1

Factors That May Affect Future Performance

Managing Growth We have grown rapidly, with our Net sales increasing from $221.5 million in 2001 to $945.0 million for 2006. Our growth has placed, and will continue to place, a strain on our management, production, product distribution network, information systems and other resources. In response to these challenges, management has continued to invest in increased production capacity, enhanced operating and financial infrastructure and information systems and continued expansion of the human resources in our operations. Our expenditures for advertising and other marketing-related activities are made as advertising rates are favorable to us and as the continued growth in the business allows us the ability to invest in building our brand.

Competition Participants in the mattress and pillow industries compete primarily on price, quality, brand name recognition, product availability and product performance. We compete with a number of different types of mattress alternatives, including standard innerspring mattresses, other 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 and strong brand name recognition, and sell their products through broad and well established distribution channels. Additionally, we believe that a number of our significant competitors offer mattress products claimed to be similar to our TEMPUR® mattresses and pillows. We provide strong channel profits to our retailers and distributors which management believes will continue to provide an attractive business model for our retailers and discourage them from carrying competing lower-priced products.

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. We believe that the premium and specialty bedding categories that we target will continue to grow at a faster rate than the overall mattress industry and we believe we will continue to experience the benefits of this consumer adoption.

Table of Contents

In addition, by expanding distribution within our existing accounts, we believe we have the opportunity to grow our business by expanding our sales force as necessary and extending our product line. Expansion gives our salespeople fewer stores to call on, resulting in more time spent with each retail location so they can work with them on merchandising, training and educating retail associates about the benefits of our products. Additionally, by extending our product line, we should be able to continue to expand the number of Tempur-Pedic models offered at the retail store level which should lead to increased sales.

Expanding distribution into new stores is also a source of growth opportunities. Our products are currently sold in approximately 6,050 furniture and bedding retail stores in the U. S., out of a total of approximately 10,000 stores we have identified as appropriate targets. Within this addressable market of approximately 10,000 stores, our plan is to increase our total penetration to a total of 7,000 to 8,000 over time. Our products are also sold in approximately 4,450 furniture retail and department stores outside the U.S., out of a total of approximately 7,000 stores that we have identified as appropriate targets. We are continuing to develop products that are responsive to consumer demand in our markets internationally.

In addition to these growth opportunities, management believes that we currently supply only a small percentage of approximately 15,400 nursing homes and 5,000 hospitals in the U.S., with a collective bed count in excess of 2.7 million. 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. We have recently begun partnering with healthcare vendors in an indirect sales method whereby the vendor integrates our product into their products, in order to improve patient comfort and wellness.

We are also focused on the hospitality industry and have recently devoted increased resources to this important area. We believe there are growth opportunities for our products through this channel as well as the opportunity to increase consumer trial and brand awareness. We have now retained approximately 20 independent sales representatives who are targeting certain hotel chains and attending hospitality trade shows. In addition, we have started an advertising campaign focused on this market segment.

Financial Leverage As of December 31, 2006, we had $361.1 million of Long-term debt outstanding, and our Stockholders Equity was $213.4 million. Higher financial leverage makes us more vulnerable to general adverse competitive, economic and industry conditions. We believe that operating margins combined with the inherent operating leverage in the business will enable us to continue de-leveraging the business in a manner consistent with historical experience. There can be no assurance, however, that our business will generate sufficient cash flow from operations or that future borrowings will be available under our Senior Credit Facility, or otherwise, to enable us to de-leverage the business.

Exchange Rates 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 the Tempur-Pedic International subsidiaries themselves. These hedging transactions may not succeed in managing our foreign currency exchange rate risk.

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 changes in currency values from current rates. Should currency rates change sharply, our results could be negatively impacted. See ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Exposures under Part II of this report.

Table of Contents

Critical Accounting Policies and Estimates

Our management is responsible for our financial statements and has evaluated the accounting policies to be used in their preparation. Our management believes these policies are reasonable and appropriate. The following discussion identifies those accounting policies that we believe are critical in the preparation of our financial statements, the judgments and uncertainties affecting the application of those policies and the possibility that materially different amounts will be reported under different conditions or using different assumptions.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our actual results could differ from those estimates.

Revenue Recognition Our estimates of sales returns are a critical component of our revenue recognition. We recognize sales, net of estimated returns, when we ship our products to customers and the risks and rewards of ownership are transferred to them. Estimated sales returns are provided at the time of sale, based on our level of historical sales returns. We allow returns for up to 120 days following a sale, depending on the channel and promotion. Our level of sales returns differs by channel, with our direct channel typically experiencing the highest rate of returns. Our level of returns has been consistent with our estimates and has been improving steadily over the last year as our retail channel, which experiences lower returns than other sales channels, continues to grow as a percentage of overall Net sales.

Warranties Cost of sales includes estimated costs to service warranty claims of our customers. Our estimate is based on our historical claims experience and extensive product testing that we perform from time to time. We provide a 20-year warranty for U.S. sales and a 15-year warranty for non-U.S. sales on mattresses, each prorated for the last 10 years. 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. Our estimate of warranty claims could be adversely affected if our historical experience ultimately proves to be greater than the performance of the product in our product testing. We also provide 2-year to 3-year warranties on pillows. Estimated future obligations related to these products are provided by charges to operations in the period in which the related revenue is recognized.

Impairment of Goodwill, Intangibles and Long-Lived Assets Goodwill reflected in our Consolidated Balance Sheets consists of the purchase price from the acquisition of Tempur World, Inc. in November 2002 (the Tempur Acquisition) in excess of the estimated fair values of identifiable net assets as of the date of the Tempur Acquisition. Intangibles consist of trademarks for various brands under which our products are sold. Other intangibles include our customer database for our direct channel, process technology and the formulation of our pressure-relieving TEMPUR® material.

We follow Statement of Financial Accounting Standards (SFAS) 142, Goodwill and Other Intangible Assets . SFAS 142 requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with SFAS 144. We perform an annual impairment test on all existing goodwill in the fourth quarter of each year. We performed the annual impairment test in the fourth quarter of 2006 on all existing goodwill and no impairment existed as of December 31, 2006. If facts and circumstances lead our management to believe that one of our other amortized intangible assets may be impaired, we will evaluate the extent to which the related cost is recoverable by comparing the future undiscounted cash flows estimated to be associated with that asset to the asset s carrying amount and write-down that carrying amount to fair value to the extent necessary. Although we believe our estimates and judgments are reasonable, different assumptions and judgments could result in different impairment, if any, of some or all of our recorded Goodwill and indefinite-lived intangibles of $269.0 million as of December 31, 2006 and $273.9 million as of December 31, 2005.

Table of Contents

In accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-lived Assets, long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset to the estimated future undiscounted net cash flows expected to be generated by the asset. If estimated future undiscounted net cash flows are less than the carrying amount of the asset or group of assets, the asset is considered impaired and an expense is recorded in an amount required to reduce the carrying amount of the asset to its then fair value. Although we believe that our estimates of cash flows in our application of SFAS 144 are reasonable, and based upon all available information, including historical cash flow data about the prior use of our assets, such estimates nevertheless require substantial judgments and are based upon material assumptions about future events.

Income Tax Accounting Income taxes are accounted for in accordance with SFAS 109, Accounting for Income Taxes. SFAS 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities. These deferred taxes are measured by applying the provisions of tax laws in effect at the balance sheet date.

We recognize deferred tax assets in our Consolidated Balance Sheets, and these deferred tax assets typically represent items deducted currently from operating income in the financial statements that will be deducted in future periods in tax returns. In accordance with SFAS 109, a valuation allowance is recorded against these deferred tax assets to reduce the total deferred tax assets to an amount that will, more likely than not, be realized in future periods. The valuation allowance is based, in part, on our estimate of future taxable income, the expected utilization of tax loss carryforwards, both domestic and foreign, and the expiration dates of tax loss carryforwards. Significant assumptions are used in developing the analysis of future taxable income for purposes of determining the valuation allowance for deferred tax assets which, in our opinion, are reasonable under the circumstances.

Our consolidated effective income tax rate and related tax reserves are subject to uncertainties in the application of complex tax regulations from numerous tax jurisdictions around the world. We recognize liabilities for anticipated taxes in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, taxes are and could be due. While it is often difficult to predict the final outcome or the timing of the resolution of any particular tax matter, we believe that our reserves reflect the likely outcome of known tax contingencies. The resolution of tax matters for an amount that is different than the amount reserved would be recognized in our effective income tax rate during the period in which such resolution occurs.

Stock-Based Compensation In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123R, Share-Based Payment (SFAS 123R), which is a revision of SFAS 123, Accounting for Stock Based Compensation (SFAS 123). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. Pro forma disclosure is no longer an alternative to financial statement recognition. We adopted SFAS 123R on January 1, 2006 using the modified prospective method for the transition. See ITEM 8. Financial Statements and Supplementary Data Note 1 in the Notes to Condensed Consolidated Financial Statements in Part II of this report for further discussion of our adoption of SFAS 123R.

Impact of Recently Issued Accounting Pronouncements

See ITEM 8. Financial Statements and Supplementary Data Note 2 of the Notes to Consolidated Financial Statements in Part II of this report for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

Table of Contents

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Foreign Currency Exposures

Our earnings, as a result of our global operating and financing activities, are exposed to changes in foreign currency exchange rates, which may adversely affect our results of operations and financial position. Our current outlook assumes no significant changes in currency values from current rates. Should currency rates change sharply, our results could be negatively impacted.

We protect a portion of our currency exchange exposure with foreign currency forward contracts. A sensitivity analysis indicates the potential loss in fair value on foreign currency forward contracts outstanding at December 31, 2006, resulting from a hypothetical 10% adverse change in all foreign currency exchange rates against the U.S. dollar, is approximately $1.3 million. Such losses would be largely offset by gains from the revaluation or settlement of the underlying assets and liabilities that are being protected by the foreign currency forward contracts.

We do not apply hedge accounting to the foreign currency forward contracts used to offset currency-related changes in the fair value of foreign currency denominated assets and liabilities. These contracts are marked-to-market through earnings at the same time that the exposed assets and liabilities are remeasured through earnings.

Interest Rate Risk

We are exposed to changes in interest rates. Our 2005 Senior Credit Facility and the Series A Bonds issued in connection with our New Mexico facility are variable-rate debt. We currently do not expect to seek an amendment to the 2005 Senior Credit Facility that would have the effect of fixing the interest rate of any variable-rate debt.

Interest rate changes generally do not affect the market value of such debt but do impact the amount of our interest payments and therefore, our future earnings and cash flows, assuming other factors are held constant. On December 31, 2006, we had variable-rate debt of approximately $360.0 million. Holding other variables constant, including levels of indebtedness, a one hundred basis point increase in interest rates on our variable-rate debt would cause an estimated reduction in income before income taxes for the next year of approximately $3.6 million.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
The financial statements required by this item are included in Part IV, ITEM 15 of this report and are presented beginning on page 45.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE
None.

ITEM 9A. CONTROLS AND PROCEDURES
Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, our management, including our principal executive officer and principal financial officer, concluded that our disclosure controls and procedures were effective as of December 31, 2006 and designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on our assessment and those criteria, management believes that we maintained effective internal control over financial reporting as of December 31, 2006.

Our independent registered public accounting firm, Ernst & Young LLP, has issued a report on management s assessment of our internal control over financial reporting as of December 31, 2006. That report appears on page 43 of this report.

Changes in Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting during the year ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Tempur-Pedic International Inc. and Subsidiaries:

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting that Tempur-Pedic International Inc. and Subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Tempur-Pedic International Inc. and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated February 26, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Louisville, Kentucky

February 26, 2007

Table of Contents

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Code of Ethics

We have adopted a Code of Business Conduct and Ethics within the meaning of Item 406(b) of Regulation S-K. The Code applies to our employees, executive officers and directors. Our Code of Business Conduct and Ethics is publicly available on our website at www.tempurpedic.com/ir.

If we make substantive amendments to our Code of Business Conduct and Ethics or grant any waiver, including any implicit waiver, we will disclose the nature of such amendment or waiver on our website or in a report on Form 8-K within four business days of such amendment or waiver.

Audit Committee Financial Expert

The information required by this Item is incorporated herein by reference from our definitive proxy statement for the 2007 Annual Meeting of Stockholders (the Proxy Statement) under the sections entitled Proposal One Election of Directors, and Board of Directors Meetings, Committees of the Board and Related Matters Committees of the Board.

Information relating to executive officers is set forth in Part I of this report following ITEM 1 under the caption Executive Officers of the Registrant. The other information required by this Item is incorporated herein by reference from the Proxy Statement under the sections entitled Proposal One Election of Directors, Board of Directors Meetings, Committees of the Board and Related Matters Committees of the Board, Corporate Governance and Executive Compensation and Related Information.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from the Proxy Statement under the sections entitled Executive Compensation and Related Information.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS

The information required by this Item is incorporated by reference from the Proxy Statement under the section entitled Principal Security Ownership and Certain Beneficial Owners and Equity Compensation Plan Information.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from the Proxy Statement under the section entitled Executive Compensation and Related Information Certain Relationships and Related Transactions.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated by reference from the Proxy Statement under the sections entitled Proposal Two Ratification of Independent Auditors Fees for Independent Auditors During Fiscal Year Ended December 31, 2006 and Policy on Audit Committee Pre-Approval of Audit and Non-Audit Services of Independent Auditor.

44

Table of Contents

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)

1. Financial statements:
   - Report of Ernst & Young LLP, Independent Registered Public Accounting Firm
   - Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004
   - Consolidated Balance Sheets as of December 31, 2006 and 2005
   - Consolidated Statements of Stockholders Equity for the years ended December 31, 2006, 2005, and 2004
   - Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005, and 2004
   - Notes to Consolidated Financial Statements
2. Financial Statement Schedule:
   - Schedule II Valuation of Qualifying Accounts and Reserves

All other schedules have been omitted because they are inapplicable, not required, or the information is included elsewhere in the consolidated financial statements or notes thereto.

3. Exhibits:

The following is an index of the exhibits included in this report or incorporated herein by reference.

EXHIBIT INDEX

2.1	Agreement and Plan of Merger dated as of October 4, 2002, among Fagerdala Holding B.V., Fagerdala Industri A.B., Chesterfield Properties Limited, Viking Investments S.a.r.l., Robert B. Trussell, Jr., David C. Fogg, Jeffrey P. Heath, H. Thomas Bryant, Tempur-Pedic International Inc., TWI Acquisition Corp. and Tempur World, Inc.(1)
3.1	Amended and Restated Certificate of Incorporation of Tempur-Pedic International Inc.(2)
3.2	Amended and Restated By-laws of Tempur-Pedic International Inc.(2)
4.1	Specimen certificate for shares of common stock.(2)
10.1	Credit Agreement, dated as of October 18, 2005, among Tempur-Pedic, Inc., Tempur Production USA, Inc., Dan-Foam ApS, certain other subsidiaries of Tempur-Pedic International, Inc., Banc of America, N.A., as administrative agent, Nordea Bank Denmark A/S, Suntrust Bank, and Fifth Third Bank.(11)
10.2	Amendment No. 1 to Credit Agreement, dated as of February 8, 2006, among Tempur-Pedic, Inc., Tempur Production USA, Inc., Dan-Foam ApS, certain other subsidiaries of Tempur-Pedic International, Inc., Banc of America, N.A., as administrative agent, Nordea Bank Denmark A/S, Suntrust Bank, and Fifth Third Bank.(12)
10.3	Amendment No. 2 to Credit Agreement dated as of October 18, 2005, among Tempur-Pedic, Inc., Tempur Production USA, Inc., Dan-Foam ApS, Tempur-Pedic International, Inc., Tempur World LLC, and Tempur World Holdings, LLC and certain other subsidiaries as guarantors, Bank of America, N.A., Nordea Bank Danmark A/S, Fifth Third Bank, SunTrust Bank, JPMorgan Chase Bank, N.A. and Wells Fargo Bank, N.A.
10.4	Trust Indenture, dated September 1, 2005, by and between Bernalillo County and The Bank of New York Trust Company, N.A., as Trustee.(11)

10.5	Lease Agreement, dated September 1, 2005, by and between Bernalillo County and Tempur Production USA, Inc.[11]

10.6	Bond Purchase Agreement, dated October 26, 2005, by and among Banc of America Securities LLC, Tempur Production USA, Inc. and Bernalillo County.(11)
10.7	Bond Purchase Agreement, dated October 26, 2005, by and among Tempur World LLC, Tempur Production USA, Inc. and Bernalillo County.(11)
10.8	Remarketing and Interest Services Agreement, dated September 1, 2005, by and between Tempur Production USA, Inc. and Banc of America Securities LLC.(11)
10.9	Mortgage, Assignment, Security Agreement and Fixture Filing, dated as of October 27, 2005, by and between Bernalillo County and Tempur Production USA, Inc.(11)
10.10	Registration Rights Agreement dated as of November 1, 2002, among Tempur-Pedic International Inc., Friedman Fleischer & Lowe Capital Partners, LP, FFL Executive Partners, LP, TA IX, L.P., TA/Atlantic and Pacific IV, L.P., TA Strategic Partners Fund A L.P., TA Strategic Partners Fund B L.P., TA/Advent VIII L.P., TA Investors LLC, TA Subordinated Debt Fund, L.P., Gleacher Mezzanine Fund I, L.P., Gleacher Mezzanine Fund P, L.P. and the investors listed on Schedule I thereto.(1)
10.11	Tempur-Pedic International Inc. 2002 Stock Option Plan.(1)(15)
10.12	Tempur-Pedic International Inc. 2003 Equity Incentive Plan.(2)(15)
10.13	Tempur-Pedic International Inc. 2003 Employee Stock Purchase Plan.(2)(15)
10.14	Employment and Noncompetition Agreement dated as of June 29, 2006 and effective as of April 28, 2006, between Tempur-Pedic International Inc. and H. Thomas Bryant.(1)(15)
10.15	Employment and Noncompetition Agreement dated as of July 11, 2003, between Tempur World, Inc. and Dale E. Williams.(1)(15)
10.16	Employment Agreement dated September 12, 2003, between Tempur International Limited and David Montgomery.(5)(15)
10.17	Stock Option Agreement dated as of July 13, 2004 between Tempur-Pedic International Inc. and Sir Paul Judge.(7)(15)
10.18	Stock Option Agreement dated as of March 12, 2004 between Tempur-Pedic International Inc. and Nancy F. Koehn.(8)(15)
10.19	Stock Option Agreement dated as of September 30, 2003 between Tempur-Pedic International Inc. and Robert B. Trussell, Jr.(9)(15)
10.20	Stock Option Agreement dated as of February 24, 2003 between Tempur-Pedic International Inc. and David Montgomery.(9)(15)
10.22	Stock Option Agreement dated as of July 7, 2003 between Tempur-Pedic International Inc. and Dale E. Williams.(9)(15)
10.23	Stock Option Agreement dated as of September 30, 2003 between Tempur-Pedic International Inc. and H. Thomas Bryant.(9)(15)
10.25	Stock Option Agreement dated as of November 1, 2002 between Tempur-Pedic International Inc. and H. Thomas Bryant.(9)(15)
10.26	Stock Option Agreement dated as of November 1, 2002 between Tempur-Pedic International Inc. and Robert B. Trussell, Jr.(9)(15)
10.27	Stock Option Agreement dated as of March 26, 2003 between Tempur-Pedic International Inc. and Francis A. Doyle.(9)(15)
10.28	Stock Option Agreement dated as of September 30, 2003 between Tempur-Pedic International Inc. and Francis A. Doyle.(9)(15)

Table of Contents

10.29	Stock Option Agreement dated as of September 30, 2003 between Tempur-Pedic International Inc. and David Montgomery.[9][15]
10.30	Employment and Noncompetition Agreement dated as of December 1, 2004, between Tempur-Pedic International Inc. and Matthew D. Clift.[10][15]
10.31	Option Agreement dated as of December 1, 2004 between Tempur-Pedic International Inc. and Matthew D. Clift.[10][15]
10.32	Restricted Stock Unit Award Agreement dated as of December 1, 2004 between Tempur-Pedic International Inc. and Matthew D. Clift.[10][15]
10.33	Stock Option Agreement dated as of February 23, 2006 between Tempur-Pedic International Inc. and Matthew D. Clift.[15]
10.34	Stock Option Agreement dated as of February 23, 2006 between Tempur-Pedic International Inc. and Sir Paul Judge.[15]
10.35	Stock Option Agreement dated as of February 23, 2006 between Tempur-Pedic International Inc. and Nancy F. Koehn.[15]
10.36	Stock Option Agreement dated as of June 26, 2006 between Tempur-Pedic International Inc. and H. Thomas Bryant.[13][15]
10.37	Stock Option Agreement dated May 2, 2005 between Tempur-Pedic International Inc. and Bhaskar Rao.[13][15]
10.38	Stock Option Agreement dated October 25, 2005 between Tempur-Pedic International Inc. and Bhaskar Rao.[13][15]
10.39	Stock Option Agreement dated February 16, 2006 between Tempur-Pedic International Inc. and Bhaskar Rao.[13][15]
10.40	Stock Option Agreement dated May 11, 2006 between Tempur-Pedic International Inc. and Bhaskar Rao.[13][15]