

TEMPUR SEALY INTERNATIONAL, INC.
Form 10-Q
November 08, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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

For the transition period from
to

Commission file number 001-31922

TEMPUR SEALY INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware

33-1022198

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

1000 Tempur Way

Lexington, Kentucky 40511

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>	Emerging Growth Company <input type="checkbox"/>
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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the registrant's common stock as of November 5, 2018 was 54,499,053 shares.

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Special Note Regarding Forward-Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, (this "Report"), including the information incorporated by reference herein, may be characterized as forward-looking under the Private Securities Litigation Reform Act of 1995. These statements may include information concerning one or more of our plans; objectives; goals; strategies; future events; future revenues or performance; the anticipated impact on our business and financial performance resulting from the termination of our relationship with Mattress Firm, Inc. ("Mattress Firm"); the impact of the macroeconomic environment in both the U.S. and internationally (including the impact of highly inflationary economies) on our business segments and expectations regarding growth of the mattress industry; uncertainties arising from global events; the effects of discontinued operations on our operating results and future performance, risks associated with our international operations; general economic, financial and industry conditions, particularly conditions relating to the financial performance and related credit issues present in the retail sector, as well as consumer confidence and the availability of consumer financing; price and product competition in our industry, particularly as a result of the importation of goods from outside the United States; consumer acceptance of our products; the ability to continuously improve and expand our product line, maintain efficient, timely and cost-effective production and delivery of products, and manage growth; the ability to expand brand awareness, the ability to expand distribution both through third parties and through direct sales; the ability to develop and successfully launch new products; the efficiency and effectiveness of our advertising campaigns and other marketing programs; the ability to increase sales productivity within existing retail accounts and to further penetrate the retail channel, including the timing of opening or expanding within large retail accounts and the timing and success of product launches; the effects of consolidation of retailers on revenues and costs; changes in demand for the Company's products by significant retailer customers; the effects of strategic investments on our operations, including our efforts to expand our global market share; changing commodity costs; changes in product and channel mix and the impact on the Company's gross margin; initiatives to improve gross margin; our capital structure and increased debt level, including our ability to meet financial obligations and continue to comply with the terms and financial ratio covenants of our credit facilities; changes in interest rates; changes in tax rates and changes in tax laws generally, including the ability to utilize tax loss carryforwards; effects of changes in foreign exchange rates on our reported earnings; our determination to apply highly inflationary accounting to the financial statements of our Argentine subsidiary, the outcome of pending tax audits or other tax, regulatory or litigation proceedings and similar issues; the effect of legislative or regulatory changes, including implementation of the European General Data Protection Regulation in May 2018; the outcome of regulatory and investigation proceedings, and outstanding litigation; financial flexibility; our expected sources of cash flow; changes in capital expenditures; our ability to effectively manage cash, and expectations regarding our target leverage and our share repurchase program. Many, but not all, of these statements appear, in particular, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in ITEM 2 of Part I of this Report. When used in this report, the words "assumes," "estimates," "expects," "guidance," "anticipates," "proposed," "projects," "plans," "targets," "intends," "believes" and variations of such words or similar expressions are intended to identify forward-looking statements. These forward-looking statements are based upon our current expectations and various assumptions. There can be no assurance that we will realize our expectations or that our beliefs will prove correct.

There are a number of risks, uncertainties and other important factors, many of which are beyond the Company's control, that could cause our actual results to differ materially from those expressed as forward-looking statements in this report, including the risk factors discussed under the heading "Risk Factors" under ITEM 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2017 and the risks identified in ITEM 1A of Part II of this Report. In addition, there may be other factors that may cause our actual results to differ materially from the forward-looking statements.

All forward-looking statements attributable to us apply only as of the date of this Report and are expressly qualified in their entirety by the cautionary statements included in this Report. Except as may be required by law, we undertake no

obligation to publicly update or revise any of the forward-looking statements, whether as a result of new information, future events, or otherwise.

When used in this Report, except as specifically noted otherwise, the term "Tempur Sealy International" refers to Tempur Sealy International, Inc. only, and the terms "Company," "we," "our," "ours" and "us" refer to Tempur Sealy International, Inc. and its consolidated subsidiaries. When used in this Report, the term "Sealy" refers to Sealy Corporation and its historical subsidiaries. In addition, when used in this Report "2016 Credit Agreement" refers to the Company's senior credit facility entered into in the first quarter of 2016; "2012 Credit Agreement" refers to the Company's prior senior credit facility entered into in 2012; "2026 Senior Notes" refers to the 5.50% senior notes due 2026 issued in 2016; and "2023 Senior Notes" refers to the 5.625% senior notes due 2023 issued in 2015.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

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

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net sales	\$729.5	\$711.5	\$2,026.8	\$2,069.2
Cost of sales	429.5	404.5	1,189.3	1,216.1
Gross profit	300.0	307.0	837.5	853.1
Selling and marketing expenses	145.9	152.0	444.6	451.4
General, administrative and other expenses	73.2	66.5	206.0	199.8
Customer termination charges, net	—	—	—	14.4
Equity income in earnings of unconsolidated affiliates	(3.8)	(3.5)	(11.5)	(10.6)
Royalty income, net of royalty expense	—	(5.3)	—	(15.0)
Operating income	84.7	97.3	198.4	213.1
Other expense, net:				
Interest expense, net	23.6	22.1	69.5	65.4
Other expense (income), net	1.4	1.0	(1.8)	(6.7)
Total other expense, net	25.0	23.1	67.7	58.7
Income from continuing operations before income taxes	59.7	74.2	130.7	154.4
Income tax provision	(15.6)	(21.0)	(34.4)	(46.5)
Income from continuing operations	44.1	53.2	96.3	107.9
Loss from discontinued operations, net of tax	(2.7)	(12.0)	(10.9)	(13.0)
Net income before non-controlling interest	41.4	41.2	85.4	94.9
Less: Net loss attributable to non-controlling interest	(0.9)	(3.4)	(2.8)	(8.1)
Net income attributable to Tempur Sealy International, Inc.	\$42.3	\$44.6	\$88.2	\$103.0
Earnings per common share:				
Basic				
Earnings per share for continuing operations	\$0.83	\$1.05	\$1.82	\$2.15
Loss per share for discontinued operations	(0.05)	(0.22)	(0.20)	(0.24)
Earnings per share	\$0.78	\$0.83	\$1.62	\$1.91
Diluted				
Earnings per share for continuing operations	\$0.82	\$1.03	\$1.80	\$2.13
Loss per share for discontinued operations	(0.05)	(0.22)	(0.20)	(0.24)
Earnings per share	\$0.77	\$0.81	\$1.60	\$1.89
Weighted average common shares outstanding:				
Basic	54.5	54.0	54.4	54.0
Diluted	55.1	54.9	55.0	54.6

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ in millions)

(unaudited)

	Three Months		Nine Months	
	Ended	Ended	Ended	Ended
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
Net income before non-controlling interests	\$41.4	\$41.2	\$85.4	\$94.9
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustments	2.4	9.6	(8.7)	27.7
Pension benefits loss, net of tax	—	—	(0.6)	—
Unrealized loss on cash flow hedging derivatives, net of tax	—	—	—	(0.6)
Other comprehensive income (loss), net of tax	2.4	9.6	(9.3)	27.1
Comprehensive income	43.8	50.8	76.1	122.0
Less: Comprehensive loss attributable to non-controlling interest	(0.9)	(3.4)	(2.8)	(8.1)
Comprehensive income attributable to Tempur Sealy International, Inc.	\$44.7	\$54.2	\$78.9	\$130.1

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(\$ in millions)

	September 30, 2018	December 31, 2017
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 32.1	\$ 41.1
Accounts receivable, net	374.1	310.8
Inventories	220.5	179.1
Prepaid expenses and other current assets	243.3	63.4
Current assets of discontinued operations	7.6	13.0
Total Current Assets	877.6	607.4
Property, plant and equipment, net	421.0	433.5
Goodwill	726.5	732.7
Other intangible assets, net	657.0	667.1
Deferred income taxes	22.8	23.4
Other non-current assets	102.3	227.3
Non-current assets of discontinued assets	1.5	2.6
Total Assets	\$ 2,808.7	\$ 2,694.0
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 266.6	\$ 228.3
Accrued expenses and other current liabilities	376.0	222.3
Income taxes payable	11.2	28.2
Current portion of long-term debt	73.0	72.4
Current liabilities of discontinued operations	6.9	25.7
Total Current Liabilities	733.7	576.9
Long-term debt, net	1,616.0	1,680.7
Deferred income taxes	121.7	114.3
Other non-current liabilities	126.7	206.1
Non-current liabilities of discontinued operations	1.1	1.3
Total Liabilities	2,599.2	2,579.3
Commitments and contingencies—see Note 10		
Redeemable non-controlling interest	—	2.2
Total Stockholders' Equity	209.5	112.5
Total Liabilities, Redeemable Non-Controlling Interest and Stockholders' Equity	\$ 2,808.7	\$ 2,694.0

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (\$ in millions) (unaudited)

	Nine Months Ended September 30, 2018 2017	
CASH FLOWS FROM OPERATING ACTIVITIES FROM CONTINUING OPERATIONS:		
Net income before non-controlling interests	\$85.4	\$94.9
Loss from discontinued operations, net of tax	10.9	13.0
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	65.2	60.1
Amortization of stock-based compensation	19.6	8.5
Amortization of deferred financing costs	1.8	1.6
Bad debt expense	9.7	9.0
Deferred income taxes	9.2	(17.1)
Dividends received from unconsolidated affiliates	13.0	8.7
Equity income in earnings of unconsolidated affiliates	(11.5)	(10.6)
Loss on disposal of assets	2.2	1.7
Foreign currency adjustments and other	(2.4)	(2.1)
Changes in operating assets and liabilities	(72.5)	48.9
Net cash provided by operating activities from continuing operations	130.6	216.6
CASH FLOWS FROM INVESTING ACTIVITIES FROM CONTINUING OPERATIONS:		
Purchases of property, plant and equipment	(55.8)	(43.1)
Other	0.3	0.9
Net cash used in investing activities from continuing operations	(55.5)	(42.2)
CASH FLOWS FROM FINANCING ACTIVITIES FROM CONTINUING OPERATIONS:		
Proceeds from borrowings under long-term debt obligations	863.0	985.9
Repayments of borrowings under long-term debt obligations	(922.7)	(1,124.7)
Proceeds from exercise of stock options	4.2	6.5
Treasury stock repurchased	(3.5)	(44.9)
Payments of deferred financing costs	—	(0.5)
Other	(4.7)	(2.9)
Net cash used in financing activities from continuing operations	(63.7)	(180.6)
Net cash provided by (used in) continuing operations	11.4	(6.2)
CASH USED IN DISCONTINUED OPERATIONS		
Operating cash flows	(17.6)	(14.1)
Investing cash flows	(0.2)	3.7
Financing cash flows	—	—
Net cash used in discontinued operations	(17.8)	(10.4)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		
Decrease in cash and cash equivalents	(2.1)	(7.3)
	(8.5)	(23.9)
CASH AND CASH EQUIVALENTS, beginning of period	41.9	65.7
CASH AND CASH EQUIVALENTS, end of period	33.4	41.8

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LESS: CASH AND CASH EQUIVALENTS OF DISCONTINUED OPERATIONS	1.3	2.2
CASH AND CASH EQUIVALENTS OF CONTINUING OPERATIONS	\$32.1	\$ 39.6

Supplemental cash flow information:

Cash paid during the period for:

Interest	\$54.0	\$ 50.6
Income taxes, net of refunds	22.0	44.2

See accompanying Notes to Condensed Consolidated Financial Statements.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (unaudited)

(1) Summary of Significant Accounting Policies

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

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

The Company completed an evaluation of its International operations and identified certain Latin American subsidiaries with low profitability and difficult operating environments with higher operational risk and volatility. As a result, the Company has decided to divest of the net assets of certain subsidiaries in the Latin American region and enter into licensee arrangements in these markets. The decision to convert the Latin American region to a licensee model represents a strategic shift in the Company's business. Accordingly, the Company has classified the Latin American region results of operations and cash flows as discontinued operations in its Condensed Consolidated Statements of Income and Condensed Consolidated Statements of Cash Flows for all periods presented. For additional information, see Note 4, "Discontinued Operations," of the Condensed Consolidated Financial Statements.

The Company's Condensed Consolidated Financial Statements include the results of Comfort Revolution, LLC ("Comfort Revolution"). Prior to July 11, 2018, Comfort Revolution constituted a variable interest entity for which the Company was considered to be the primary beneficiary due to the Company's disproportionate share of the economic risk associated with its equity ownership of 45%, debt financing and other factors. On July 11, 2018, the Company acquired the remaining 55% equity interest in Comfort Revolution, which was accounted for as an equity transaction and did not result in a material impact to the Company's Condensed Consolidated Financial Statements.

The Company also has ownership interests in a group of Asia-Pacific joint ventures to develop markets for Sealy® branded products in those regions. The Company's ownership interest in these joint ventures is 50.0%. The equity method of accounting is used for these joint ventures, over which the Company has significant influence but does not have control, and consolidation is not otherwise required. The Company's carrying value in its equity method investments of \$18.7 million and \$21.5 million at September 30, 2018 and December 31, 2017, respectively, is recorded in other non-current assets within the accompanying Condensed Consolidated Balance Sheets. The Company's equity in the net income and losses of these investments is recorded as equity income in earnings of unconsolidated affiliates in the accompanying Condensed Consolidated Statements of Income.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States ("GAAP") for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Company and related footnotes for the year ended December 31, 2017, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2018.

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

(b) Adoption of New Accounting Standards.

Revenue Recognition. On January 1, 2018, the Company adopted Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" using the modified retrospective method. Under the modified retrospective method, the Company recognized the cumulative effect of initially applying the new revenue standard as a decrease to the opening balance of retained earnings. Adoption of Topic 606 did not have a material impact on the Company's financial statements. For additional information, see Note 3, "Revenue Recognition" of the Condensed Consolidated Financial Statements.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Pensions. In March 2017, the FASB issued ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost", which is accounting guidance that changed how employers who sponsor defined benefit pension and/or postretirement benefit plans present the net periodic benefit cost in the Condensed Consolidated Statements of Income. This guidance requires employers to present the service cost component of net periodic benefit cost in the same caption within the Condensed Consolidated Statements of Income as other employee compensation costs from services rendered during the period. All other components of the net periodic benefit cost are presented separately outside of the operating income caption. The Company adopted ASU No. 2017-07 as of January 1, 2018 and applied the accounting guidance retrospectively. Adoption of this guidance resulted in a reclassification of pension and other postretirement plan non-service income and remeasurement adjustments, net, from within operating income to non-operating income. The adoption of this guidance was not material to the Condensed Consolidated Statement of Income in the current or prior year.

Accumulated Other Comprehensive Income. In February 2018, the FASB issued ASU No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income", which allows entities to reclassify tax effects stranded in accumulated other comprehensive loss ("AOCL") as a result of the Tax Cuts and Jobs Act of 2017 ("U.S. Tax Reform Act") to retained earnings. The Company early adopted ASU No. 2018-02 on March 31, 2018. The reclassification from AOCL to retained earnings is not material to the Condensed Consolidated Balance Sheet and Condensed Consolidated Statements of Income or Comprehensive Income.

Derivatives and Hedging. In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities", which simplifies hedge accounting by better aligning a company's financial reporting for hedging relationships with its risk management activities. This guidance expands an entity's ability to hedge non-financial and financial risk components and reduces complexity in fair value hedges of interest rate risk; eliminates the requirement to separately measure and report hedge ineffectiveness and present the entire change in the fair value of a hedging instrument in the same income statement line as the hedged item; eases certain documentation and assessment requirements; and modifies the accounting for components excluded from the assessment of hedge effectiveness.

The Company early adopted this ASU in the third quarter of 2018, retrospectively. There were no adjustments to the Company's Condensed Consolidated Financial Statements as a result of the adoption.

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

	September 30, 2018	December 31, 2017
(in millions)		
Finished goods	\$ 144.0	\$ 119.6
Work-in-process	12.1	11.3
Raw materials and supplies	64.4	48.2
	\$ 220.5	\$ 179.1

(d) **Accrued Sales Returns.** The Company allows product returns through certain sales channels and on certain products. Estimated sales returns are provided at the time of sale based on historical sales channel return rates. Estimated future obligations related to these products are provided by a reduction of sales in the period in which the

revenue is recognized. Accrued sales returns are included in accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheets. Effective January 1, 2018 with the Company's adoption of Topic 606, the Company recognizes a return asset for the right to recover the goods returned by the customer. The right of return asset is recognized on a gross basis outside of the accrued sales returns and is not material to the Company's Condensed Consolidated Balance Sheets.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The Company had the following activity for sales returns from December 31, 2017 to September 30, 2018:
(in millions)

Balance as of December 31, 2017	\$30.0
Reclassification and remeasurement of sales return asset under Topic 606	1.7
Balance as of January 1, 2018	31.7
Amounts accrued	72.5
Returns charged to accrual	(68.4)
Balance as of September 30, 2018	\$35.8

As of September 30, 2018 and December 31, 2017, \$23.4 million and \$19.6 million of accrued sales returns are included as a component of accrued expenses and other current liabilities and \$12.4 million and \$10.4 million, respectively, of accrued sales returns are included in other non-current liabilities on the Company's accompanying Condensed Consolidated Balance Sheets.

(e) Warranties. The Company provides warranties on certain products, which vary by segment, product and brand. Estimates of warranty expenses are based primarily on historical claims experience and product testing. Estimated future obligations related to these products are charged to cost of sales in the period in which the related revenue is recognized. The Company considers the impact of recoverable salvage value on warranty costs in determining its estimate of future warranty obligations.

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

The Company had the following activity for its accrued warranty expense from December 31, 2017 to September 30, 2018:

(in millions)	
Balance as of December 31, 2017	\$36.7
Remeasurement of obligations under Topic 606	2.8
Balance as of January 1, 2018	39.5
Amounts accrued	29.0
Warranties charged to accrual	(31.8)
Balance as of September 30, 2018	\$36.7

As of September 30, 2018 and December 31, 2017, \$15.1 million and \$16.7 million of accrued warranty expense is included as a component of accrued expenses and other current liabilities and \$21.6 million and \$20.0 million of accrued warranty expense is included in other non-current liabilities in the Company's accompanying Condensed Consolidated Balance Sheets, respectively.

(f) Allowance for Doubtful Accounts. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's accounts receivable. The Company regularly reviews the adequacy of its allowance for doubtful accounts. The Company determines the allowance based on historical write-off experience and current economic conditions and also considers factors such as customer credit, past transaction

history with the customer and changes in customer payment terms when determining whether the collection of a customer receivable is reasonably assured. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts included in accounts receivable, net in the accompanying Condensed Consolidated Balance Sheets was \$31.9 million and \$24.7 million as of September 30, 2018 and December 31, 2017, respectively.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

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

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

For derivative financial instruments that are designated as a hedge, unrealized gains and losses related to the effective portion are either recognized in income immediately to offset the realized gain or loss on the hedged item, or are deferred and reported as a component of AOCL in stockholders' equity and subsequently recognized in net income when the hedged item affects net income. The change in fair value of the ineffective portion of a derivative financial instrument is recognized in net income immediately. The effectiveness of the cash flow hedge contracts, including time value, is assessed prospectively and retrospectively on a monthly basis using regression analysis, as well as other timing and probability criteria. For derivative instruments that are not designated as hedges, the gain or loss related to the change in fair value is also recorded in net income immediately.

The forward exchange contract asset and liability as of September 30, 2018 and December 31, 2017 were based on Level 2 inputs and were not material in either period.

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

In October 2018, the Company entered into cross currency interest rate swap agreements with a notional amount of \$50.0 million maturing in June of 2021. The net effect of these cross currency swap agreements is to convert a portion of the Company's 5.50% fixed-rate USD-denominated 2026 Senior notes, including the semi-annual interest payments thereunder, to fixed-rate DKK denominated debt at a rate of 2.0575%. The Company has designated these cross currency swap agreements as net investment hedges. The differential in the interest rate is recognized through interest expense on the Condensed Consolidated Statement of Income and all other changes in the fair value of the net investment hedge are recognized through equity.

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

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

(i) Customer Contract Termination. During the week of January 23, 2017, the Company was unexpectedly notified by the senior management of Mattress Firm and representatives of Steinhoff International Holdings Ltd. ("Steinhoff"), its parent company, of Mattress Firm's intent to terminate its business relationship with the Company if the Company did not agree to considerable changes to its agreements with Mattress Firm, including significant economic concessions. The Company engaged in discussions to facilitate a mutually agreeable supply arrangement with Mattress Firm. However, the parties were unable to reach an agreement, and on January 27, 2017, Tempur-Pedic North America, LLC ("Tempur-Pedic") and Sealy Mattress Company ("Sealy Mattress") issued formal termination notices for all of their products to Mattress Firm. On January 30, 2017, Tempur-Pedic and Sealy Mattress entered into transition agreements with Mattress Firm in which they agreed, among other things, to continue supplying Mattress Firm until April 3, 2017, at which time the parties' business relationships ended.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

In the first quarter of 2017, the Company took steps to manage its cost structure as a result of the termination of the contracts with Mattress Firm. For the three months ended March 31, 2017, the Company recognized \$25.9 million of net charges associated with the termination of the relationship with Mattress Firm. This amount includes \$11.5 million of charges within cost of sales and \$14.4 million of charges within customer termination charges, net in the Condensed Consolidated Statements of Income. The following amounts are recognized in cost of sales: \$5.4 million of charges related to the write-off of customer-unique inventory and \$6.1 million of increased warranty costs associated with claims historically retained by Mattress Firm. The following amounts are recognized in customer termination charges, net: \$22.8 million of charges related to the write-off of Mattress Firm incentives and marketing assets, employee-related expenses and professional fees; and \$0.9 million of accelerated stock-based compensation expense. These charges are offset by \$9.3 million of benefit related to the change in estimate associated with performance-based stock compensation that is no longer probable of payout as a result of the termination of the contracts with Mattress Firm.

In the three months ended March 31, 2017, the Company also recognized \$9.3 million related to the payments received pursuant to the transition agreements with Mattress Firm. This amount is included within other income, net in the Condensed Consolidated Statements of Income.

(j) Highly Inflationary Economy. Effective June 30, 2018, the Company determined that the economy in Argentina is highly inflationary. Beginning July 1, 2018, the U.S. Dollar is the functional currency for the Company's subsidiaries in Argentina. Remeasurement adjustments in a highly inflationary economy and other transactional gains and losses are reflected in net earnings and were not material for the three months ended September 30, 2018. These subsidiaries are included in loss from discontinued operations, net of tax, within the Company's Condensed Consolidated Statements of Income.

(2) Recently Issued Accounting Pronouncements

Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)", which requires lessees to recognize most assets and liabilities on the balance sheet for the rights and obligations created by leases and provides for expanded disclosures on key information about leasing arrangements. Topic 842 is effective for the Company on January 1, 2019. In transition, the Company is required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.

The FASB recently issued ASU No. 2018-11, "Leases (Topic 842): Targeted Improvements", which allows entities to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in the consolidated financial statements. This ASU allows entities to continue to apply the legacy guidance in Topic 840, including its disclosure requirements, in the comparative periods presented in the year the new leases standard is adopted. Entities that elect this option would still adopt the new leases standard using a modified retrospective transition method, but would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented. The Company expects to elect this transition option.

The Company's operating lease portfolio primarily includes manufacturing facility, warehouse, retail store and equipment leases. Upon adoption of Topic 842, the Company expects to recognize a right of use asset and liability

related to substantially all operating lease arrangements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. The Company expects to elect the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allows the Company to carryforward the historical lease classification. The Company does not expect to elect the hindsight practical expedient to determine the lease term for existing leases.

The Company has conducted a risk assessment and has developed a transition plan that will enable the Company to meet the implementation requirement. The Company is in the process of determining the scope of the impact and gathering and assessing data. Additionally, the Company is evaluating its processes and internal controls to meet the accounting, reporting and disclosure requirements of Topic 842. While the Company is currently evaluating Topic 842 to determine the specific impact it will have on the Company's Condensed Consolidated Financial Statements, the adoption is expected to result in a material increase in the assets and liabilities recorded on the balance sheet.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(3) Revenue Recognition

Revenue from Contracts with Customers

On January 1, 2018, the Company adopted Topic 606 using the modified retrospective method. Topic 606 required additional qualitative and quantitative disclosures. Other presentation and disclosure changes include the classification of royalty income to net sales and changes in the balance sheet classification and measurement for accrued sales returns and accrued warranty expenses.

The Company recognized the cumulative effect of adoption as an adjustment to the opening balance of retained earnings for approximately \$3.0 million, net of tax. Additionally, as a result of the new standard and effective January 1, 2018, the Company classifies royalty income within net sales. The comparative information has not been restated and continues to be reported under the accounting standards in effect for each period presented.

The Company evaluated the impact of the adoption on the classification of cooperative advertising programs and other promotional programs with the Company's customers. The impact of adoption to these promotional programs did not result in material changes in the Company's recognition or presentation of costs within the Company's Condensed Consolidated Statements of Income.

The following tables summarize the impact of adopting Topic 606 on the Company's Condensed Consolidated Financial Statements as of and for the periods ended September 30, 2018:

(in millions)	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	As Reported	Balances		As Reported	Balances	
		Without Adoption of Topic 606	Effect of Change Higher/(Lower)		Without Adoption of Topic 606	Effect of Change Higher/(Lower)
Statement of Income						
Net sales	\$729.5	\$ 724.0	\$ 5.5	\$2,026.8	\$ 2,010.5	\$ 16.3
Royalty income, net of royalty expense	—	5.5	(5.5)	—	16.3	(16.3)

(in millions)	September 30, 2018		
	As Reported	Balances	
		Without Adoption of Topic 606	Effect of Change Higher/(Lower)
Balance Sheet			
Assets			
Prepaid expenses and other current assets	\$243.3	\$ 242.0	\$ 1.3
Deferred income taxes	22.8	21.9	0.9
Other non-current assets	102.3	101.4	0.9
Liabilities			
Accrued expenses and other current liabilities	\$376.0	\$ 373.4	\$ 2.6

Other non-current liabilities	126.7	123.8	2.9
Stockholders' Equity			
Total stockholders' equity	\$209.5	\$ 211.9	\$ (2.4)

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Disaggregation of Revenue

The following table presents the Company's disaggregated revenue by channel, product and geographical region, including a reconciliation of disaggregated revenue by segment, for the three and nine months ended September 30, 2018:

(in millions)	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	North America	International	Consolidated	North America	International	Consolidated
Channel						
Wholesale	\$553.6	\$ 107.3	\$ 660.9	\$1,501.9	\$ 343.7	\$ 1,845.6
Direct	42.2	26.4	68.6	106.7	74.5	181.2
Net sales	\$595.8	\$ 133.7	\$ 729.5	\$1,608.6	\$ 418.2	\$ 2,026.8
Product						
Bedding products	\$563.0	\$ 108.3	\$ 671.3	\$1,512.7	\$ 335.9	\$ 1,848.6
Other products	32.8	25.4	58.2	95.9	82.3	178.2
Net sales	\$595.8	\$ 133.7	\$ 729.5	\$1,608.6	\$ 418.2	\$ 2,026.8
Geographical region						
United States	\$536.8	\$ —	\$ 536.8	\$1,454.6	\$ —	\$ 1,454.6
Canada	59.0	—	59.0	154.0	—	154.0
International	—	133.7	133.7	—	418.2	418.2
Net sales	\$595.8	\$ 133.7	\$ 729.5	\$1,608.6	\$ 418.2	\$ 2,026.8

The North America and International segments sell product through two channels: Wholesale and Direct. The Wholesale channel includes all product sales to third party retailers, including third party distribution, hospitality and healthcare. The Direct channel includes product sales to company-owned stores, e-commerce and call centers. The North America and International segments classify products into two major categories: Bedding and Other. Bedding products include mattresses, foundations and adjustable foundations. Other products include pillows, mattress covers, sheets, cushions and various other comfort products.

The Wholesale channel also includes income from royalties derived by licensing Sealy® and Stearns & Foster® brands, technology and trademarks to other manufacturers. The licenses include rights for the licensees to use trademarks as well as current proprietary or patented technology that the Company utilizes. The Company also provides its licensees with product specifications, research and development, statistical services and marketing programs. The Company recognizes royalty income based on the occurrence of sales of Sealy® and Stearns & Foster® branded products by various licensees.

For product sales in each of the Company's channels, the Company recognizes a sale when the obligations under the terms of the contract with the customer is satisfied, which is generally when control of the product has transferred to the customer. Transferring control of each product sold is considered a separate performance obligation. The Company transfers control and recognizes a sale when it ships the product to a customer or when the customer

receives the product based upon agreed shipping terms. Each unit sold is considered an independent, unbundled performance obligation. The Company does not have any additional performance obligations other than product sales that are material in the context of the contract. The Company also offers assurance type warranties on certain of its products. A warranty is considered an assurance type warranty if it provides the consumer with assurance that the product will function as intended. Assurance type warranties are not accounted for as separate performance obligations under the revenue model.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The transaction price is measured as the amount of consideration the Company expects to receive in exchange for transferring goods. The amount of consideration the Company receives, and correspondingly, the revenue that is recognized, varies due to sales incentives and returns the Company offers to its wholesale and retail channel customers. Specifically, the Company extends volume discounts, as well as promotional allowances, floor sample discounts, commissions paid to retail associates and slotting fees to its Wholesale channel customers and reflects these amounts as a reduction of sales at the time revenue is recognized based on historical experience. The Company allows returns following a sale, depending on the channel and promotion. The Company reduces revenue and cost of sales for its estimate of the expected returns, which is primarily based on the level of historical sales returns. The Company does not offer extended payment terms beyond one year to customers. As such, the Company does not adjust its consideration for financing arrangements.

In certain jurisdictions, the Company is subject to certain non-income taxes including, but not limited to, sales tax, value added tax, excise tax and other taxes. These taxes are excluded from the transaction price, and therefore, excluded from revenue. The Company has elected to account for shipping and handling activities as a fulfillment cost as permitted by Topic 606. Accordingly, the Company reflects all amounts billed to customers for shipping and handling in revenue and the costs of fulfillment in cost of sales.

(4) Discontinued Operations

The Company completed an evaluation of its International segment operations and identified certain subsidiaries with low profitability and difficult operating environments with higher operational risk and volatility. As a result of this evaluation, the Company has decided to divest of the net assets of certain subsidiaries in the Latin American region and enter into licensee relationships in those markets. The Company expects to receive royalty payments from these licensee relationships in future years.

Certain of the dispositions occurred during the three months ended September 30, 2018, with the remaining actions expected to be taken over the next several months. The total gain on disposition during the three months ended September 30, 2018 was not material to the Company's Condensed Consolidated Financial Statements. The decision to convert these markets in the Latin American region to a licensee model represents a strategic shift in the Company's business. Accordingly, the Company has classified the Latin American region results of operations and cash flows as discontinued operations in its Condensed Consolidated Statements of Income and Condensed Consolidated Statements of Cash Flows for all periods presented. Certain assets and liabilities of the identified subsidiaries not yet disposed as of September 30, 2018 are classified as held for sale in the Company's Condensed Consolidated Balance Sheets. The Company will retain and has agreed to indemnify the buyers for certain liabilities of the disposed subsidiaries arising prior to the closing of the sale, including certain tax and environmental remediation liabilities. These liabilities, which are not material individually or in the aggregate, are included within accrued expenses and other current liabilities at September 30, 2018.

Components of amounts reflected in the Condensed Consolidated Statements of Income related to discontinued operations are presented in the following table for each of the periods ended September 30.

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Net sales	\$6.4	\$13.3	\$26.8	\$37.0

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Cost of sales	5.0	8.1	18.9	22.7
Gross profit	1.4	5.2	7.9	14.3
Selling and marketing expenses	2.6	3.4	10.2	10.0
General, administrative and other expenses	1.6	4.5	4.8	6.7
Operating loss	(2.8)	(2.7)	(7.1)	(2.4)
Interest expense, net and other	(0.3)	10.0	3.8	9.1
Loss from discontinued operations before income taxes	(2.5)	(12.7)	(10.9)	(11.5)
Income tax (provision) benefit	(0.2)	0.7	—	(1.5)
Net loss from discontinued operations, net of tax	\$(2.7)	\$(12.0)	\$(10.9)	\$(13.0)

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The following table presents the captions of assets and liabilities of the subsidiaries that are held for sale and presented as discontinued operations within the Company's Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017.

	September 30, 2018	December 31, 2017
Cash and cash equivalents	\$ 1.3	\$ 0.8
Accounts receivable, net	3.5	6.9
Inventories	1.9	3.9
Prepaid expenses and other current assets	0.9	1.4
Current assets of discontinued operations	\$ 7.6	\$ 13.0
Property, plant and equipment, net	\$ 1.0	\$ 1.6
Other non-current assets	0.5	1.0
Non-current assets of discontinued operations	\$ 1.5	\$ 2.6
Accounts payable	\$ 3.4	\$ 12.9
Accrued expenses and other current liabilities	2.8	11.9
Income taxes payable	0.7	0.9
Current liabilities of discontinued operations	\$ 6.9	\$ 25.7
Other non-current liabilities	\$ 1.1	\$ 1.3
Non-current liabilities of discontinued operations	\$ 1.1	\$ 1.3

(5) Goodwill

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

(in millions)	North America	International	Consolidated
Balance as of December 31, 2017	\$ 576.6	\$ 156.1	\$ 732.7
Foreign currency translation and other	(2.1)	(4.1)	(6.2)
Balance as of September 30, 2018	\$ 574.5	\$ 152.0	\$ 726.5

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(6) Debt

Debt for the Company consists of the following:

(in millions, except percentages)	September 30, 2018		December 31, 2017		Maturity Date
	Amount	Rate	Amount	Rate	
2016 Credit Agreement					
Term A Facility	\$532.5	(1)	\$555.0	(2)	April 6, 2021
Revolver	—	(1)	—	(2)	April 6, 2021
2026 Senior Notes	600.0	5.500%	600.0	5.500%	June 15, 2026
2023 Senior Notes	450.0	5.625%	450.0	5.625%	October 15, 2023
Securitized debt	13.7	(3)	49.0	(3)	April 12, 2019
Capital lease obligations ⁽⁴⁾	68.0		71.8		Various
Other	32.9		36.7		Various
Total debt	1,697.1		1,762.5		
Less: deferred financing costs	(8.1)		(9.4)		
Total debt, net	1,689.0		1,753.1		
Less: current portion	(73.0)		(72.4)		
Total long-term debt, net	\$1,616.0		\$1,680.7		

(1) Interest at LIBOR plus applicable margin of 2.00% as of September 30, 2018

(2) Interest at LIBOR plus applicable margin of 1.75% as of December 31, 2017.

(3) Interest at one month LIBOR index plus 80 basis points.

(4) Capital lease obligations are a non-cash financing activity.

2016 Credit Agreement

On April 6, 2016, the Company entered into the 2016 Credit Agreement with a syndicate of banks. The 2016 Credit Agreement requires compliance with certain financial covenants providing for maintenance of a minimum consolidated interest coverage ratio, maintenance of a maximum consolidated total net leverage ratio, and maintenance of a maximum consolidated secured net leverage ratio. The consolidated total net leverage ratio is calculated using consolidated funded debt less qualified cash. Consolidated funded debt includes debt recorded in the Condensed Consolidated Balance Sheets as of the reporting date, plus letters of credit outstanding and other short-term debt. The Company is allowed to subtract from consolidated funded debt an amount equal to 100.0% of domestic qualified cash and 60.0% of foreign qualified cash, the aggregate of which cannot exceed \$150.0 million at the end of the reporting period. As of September 30, 2018, domestic qualified cash was \$12.8 million and foreign qualified cash was \$11.6 million.

The Company is in compliance with all applicable covenants as of September 30, 2018.

Securitized Debt

On April 12, 2017, the Company and certain of its subsidiaries entered into a securitization transaction with respect to certain accounts receivable due to the Company and certain of its subsidiaries (the "Accounts Receivable Securitization"). In connection with this transaction, the Company and a wholly-owned special purpose subsidiary entered into a credit agreement that provides for revolving loans to be made from time to time in a maximum amount that varies over the course of the year based on the seasonality of the Company's accounts receivable and is subject to

an overall limit of \$120.0 million. The Accounts Receivable Securitization matures on April 12, 2019.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The obligations of the Company and its relevant subsidiaries under the Accounts Receivable Securitization are secured by the accounts receivable and certain related rights and the facility agreements contain customary events of default. The accounts receivable will continue to be owned by the Company and its subsidiaries and will continue to be reflected as assets on the Company's Condensed Consolidated Balance Sheets and represent collateral up to the amount of the borrowings under this facility. Borrowings under this facility are classified as long-term debt within the Condensed Consolidated Balance Sheets based on the Company's ability and intent to refinance on a long-term basis as of September 30, 2018.

On April 2, 2018, the Company and its subsidiaries entered into an amendment to its Accounts Receivable Securitization that modified certain covenants and calculations. This amendment was designed to create more flexibility and to increase average availability on the line, while not changing the overall limit or maturity.

Fair Value of Financial Instruments

Financial instruments, although not recorded at fair value on a recurring basis, include cash and cash equivalents, accounts receivable, accounts payable, and the Company's debt obligations. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value using Level 1 inputs because of the short-term maturity of those instruments. Borrowings under the 2016 Credit Agreement and the securitized debt are at variable interest rates and accordingly their carrying amounts approximate fair value. The fair value of the following material financial instruments were based on Level 2 inputs estimated using discounted cash flows and market-based expectations for interest rates, credit risk, and the contractual terms of debt instruments. The fair values of these material financial instruments are as follows:

(in millions)	Fair Value	
	September 30, 2018	December 31, 2017
2023 Senior Notes	\$449.3	\$ 470.9
2026 Senior Notes	576.9	618.1

(7) Stockholders' Equity

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

The Board is authorized, subject to any limitations prescribed by law, without further vote or action by the stockholders, to issue from time to time shares of preferred stock in one or more series. Each such series of preferred stock will have such number of shares, designations, preferences, voting powers, qualifications, and special or relative rights or privileges as determined by the Board, which may include, among others, dividend rights, voting rights, redemption and sinking fund provisions, liquidation preferences, conversion rights and preemptive rights.

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(b) Treasury Stock. As of September 30, 2018, the Company had approximately \$226.9 million remaining under the existing share repurchase authorization for repurchases of Tempur Sealy International's common stock. The Company did not repurchase any shares during the nine months ended September 30, 2018. For the nine months ended September 30, 2017, the Company repurchased 0.6 million shares for approximately \$40.1 million.

In addition, the Company acquired 0.1 million shares upon the vesting of certain performance restricted stock units ("PRSUs"), which were withheld to satisfy tax withholding obligations during each of the nine months ended September 30, 2018 and 2017. The shares withheld were valued at the closing price of the stock on the New York Stock Exchange on the vesting date or first business day thereafter, resulting in approximately \$3.5 million and \$4.8 million in treasury stock acquired during the nine months ended September 30, 2018 and 2017, respectively.

(c) AOCL. AOCL consisted of the following:

(in millions)	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Foreign Currency Translation				
Balance at beginning of period	\$(83.9)	\$(101.8)	\$(72.8)	\$(119.9)
Other comprehensive (loss) income:				
Foreign currency translation adjustments ⁽¹⁾	2.4	9.6	(8.7)	27.7
Balance at end of period	\$(81.5)	\$(92.2)	\$(81.5)	\$(92.2)
 Pensions				
Balance at beginning of period	\$(3.3)	\$(2.2)	\$(2.7)	\$(2.2)
Other comprehensive loss:				
Net change from period revaluations, net of tax	—	—	—	—
Tax expense ⁽²⁾	—	—	—	—
Total other comprehensive income before reclassifications, net of tax	\$—	\$—	\$—	\$—
Net amount reclassified to earnings ⁽¹⁾	—	—	—	—
U.S. tax reform - reclassification to retained earnings upon adoption of ASU No. 2018-02	—	—	(0.5)	—
Tax benefit ⁽²⁾	—	—	(0.1)	—
Total amount reclassified from accumulated other comprehensive loss, net of tax	\$—	\$—	\$(0.6)	\$—
Total other comprehensive loss	—	—	(0.6)	—
Balance at end of period	\$(3.3)	\$(2.2)	\$(3.3)	\$(2.2)
 Foreign Exchange Forward Contracts				
Balance at beginning of period	\$—	\$—	\$—	\$0.6
Other comprehensive loss:				
Net change from period revaluations	—	(0.2)	—	(0.6)
Tax benefit ⁽²⁾	—	—	—	0.1
Total other comprehensive loss before reclassifications, net of tax	\$—	\$(0.2)	\$—	\$(0.5)
Net amount reclassified to earnings ⁽³⁾	—	0.3	—	(0.1)
Tax benefit ⁽²⁾	—	(0.1)	—	—
Total amount reclassified from accumulated other comprehensive loss, net of tax	\$—	\$0.2	\$—	\$(0.1)
Total other comprehensive loss	—	—	—	(0.6)
Balance at end of period	\$—	\$—	\$—	\$—

(1) In 2018 and 2017, there were no tax impacts related to foreign currency translation adjustments and no amounts were reclassified to earnings.

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

(3) This amount was included in cost of sales in the accompanying Condensed Consolidated Statements of Income.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(8) Other Items

Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following:

(in millions)	September 30, December 31,	
	2018	2017
Advertising	\$ 51.4	\$ 44.4
Wages and benefits	41.3	51.4
Sales returns	23.4	19.6
Warranty	15.1	16.7
Rebates	9.4	11.4
Taxes	138.6	6.3
Other	96.8	72.5
	\$ 376.0	\$ 222.3

(9) Stock-Based Compensation

The Company's stock-based compensation expense for the three and nine months ended September 30, 2018 and 2017 included PRSUs, non-qualified stock options, restricted stock units ("RSUs") and deferred stock units ("DSUs"). A summary of the Company's stock-based compensation expense (benefit) is presented in the following table:

(in millions)	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
PRSU expense (benefit)	\$0.7	\$1.0	\$2.2	\$(7.1)
Option expense	1.6	1.8	5.4	5.6
RSU/DSU expense	4.2	3.1	12.0	10.0
Total stock-based compensation expense	\$6.5	\$5.9	\$19.6	\$8.5

During the nine months ended September 30, 2017, the Company recorded a \$9.3 million benefit in the Condensed Consolidated Statements of Income related to a change in estimate associated with performance-based stock compensation that was no longer probable of payout as a result of the termination of the Mattress Firm relationship.

In March 2018, the Compensation Committee of the Board of Directors formally determined that the Company did not have more than \$650.0 million of adjusted earnings before interest, tax, depreciation and amortization ("Adjusted EBITDA") for 2017 (the "2017 Aspirational Plan PRSUs"). As a result, approximately two-thirds of the PRSUs previously granted with a performance period for 2017 ("2017 Aspirational PRSUs") were forfeited as of this date. At September 30, 2018, the Company has 0.3 million of these 2017 Aspirational PRSUs still outstanding that will vest if the Company achieves more than \$650.0 million of Adjusted EBITDA for 2018. If the Company does not achieve more than \$650.0 million of Adjusted EBITDA in 2018, then all remaining 2017 Aspirational Plan PRSUs will be forfeited. Adjusted EBITDA is defined as the Company's "Consolidated EBITDA" as such term is defined in the 2012

Credit Agreement.

The Company did not record any stock-based compensation expense related to the 2017 Aspirational Plan PRSUs during the three and nine months ended September 30, 2018 and 2017, as it is not considered probable that the Company will achieve the specified performance target as of December 31, 2018. The Company will continue to evaluate the probability of achieving the performance condition in future periods and record the appropriate expense if necessary. Based on the price of the Company's common stock on the grant date, the total unrecognized compensation expense related to this award if the performance target is met for 2018 is \$24.8 million, which would be expensed over the remaining service period if achievement of the performance condition becomes probable.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The Company has 1.6 million PRSUs outstanding that will vest if the Company achieves a certain level of Adjusted EBITDA during four consecutive fiscal quarters as described below (the "2019 Aspirational Plan PRSUs"). The 2019 Aspirational Plan PRSUs will vest based on the highest Adjusted EBITDA in any four consecutive fiscal quarter period ending between (and including) March 31, 2018 and December 31, 2019 (the "First Designated Period"). If the highest Adjusted EBITDA in the First Designated Period is \$600.0 million, 66% will vest; if the highest Adjusted EBITDA equals or exceeds \$650.0 million, then 100% will vest; if the highest Adjusted EBITDA is between \$600.0 million and \$650.0 million then a pro rata portion will vest; and if the highest Adjusted EBITDA is less than \$600.0 million then one-half of the 2019 Aspirational Plan PRSUs will no longer be available for vesting based on performance and the remaining one-half will remain available for vesting based on the highest Adjusted EBITDA in any four consecutive fiscal quarter period ending between (and including) March 31, 2020 and December 31, 2020 (the "Second Designated Period"). If the highest Adjusted EBITDA in the Second Designated Period is \$600.0 million then 66% of the remaining 2019 Aspirational Plan PRSUs will vest; if the Adjusted EBITDA is \$650.0 million or more 100% will vest; if Adjusted EBITDA is between \$600.0 million and \$650.0 million then a pro rata portion will vest; and if Adjusted EBITDA is below \$600.0 million then all of the remaining 2019 Aspirational Plan PRSUs will be forfeited. Adjusted EBITDA is defined for purposes of the 2019 Aspirational PRSUs as the Company's "Consolidated EBITDA" as such term is defined in the 2016 Credit Agreement.

The Company did not record any stock-based compensation expense related to the 2019 Aspirational Plan PRSUs during the three and nine months ended September 30, 2018, as it is not considered probable that the Company will achieve the specified performance target for either the First Designated Period or Second Designated Period. The Company will continue to evaluate the probability of achieving the performance condition in future periods and record the appropriate expense if necessary. Based on the price of the Company's common stock on the grant date, the total unrecognized compensation expense related to this award if the performance target is met for the First Designated Period is \$93.9 million, which would be expensed over the remaining service period if achievement of the performance condition becomes probable.

(10) Commitments and Contingencies

(a) David Buehring, Individually and on Behalf of All Others Similarly Situated v. Tempur Sealy International, Inc., Scott L. Thompson, and Barry A. Hytinen, filed March 24, 2017.

On March 24, 2017, a suit was filed against Tempur Sealy International, Inc., and two of its officers in the U.S. District Court for the Southern District of New York, purportedly on behalf of a proposed class of stockholders who purchased Tempur Sealy common stock between July 28, 2016 and January 27, 2017. The complaint alleges that the Company made materially false and misleading statements regarding its then existing and future financial prospects, including those with one of its retailers, Mattress Firm, allegedly in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The Company does not believe the claims have merit and intends to vigorously defend against these claims. A Motion to Dismiss the case was filed by the Company on October 5, 2017. The case is in the early stages of litigation. As a result, the outcome of the case is unclear and the Company is unable to reasonably estimate the possible loss or range of loss, if any. Accordingly, the Company can give no assurance that this matter will not have a material adverse effect on the Company's financial position or results of operations.

(b) Myla Gardner v. Scott L. Thompson, Barry A. Hytinen, Evelyn S. Dilsaver, John A. Heil, Jon L. Luther, Usman Nabi, Richard W. Neu, Robert B. Trussell, Jr. and Tempur Sealy International, Inc., filed July 10, 2017; Joseph L. Doherty v. Scott L. Thompson, Barry A. Hytinen, Evelyn S. Dilsaver, John A. Heil, Jon L. Luther, Usman Nabi, Richard W. Neu, Robert B. Trussell, Jr. and Tempur Sealy International, Inc., filed July 20, 2017; and Paul Onesti v. Scott L. Thompson, Barry A. Hytinen, Evelyn S. Dilsaver, John A. Heil, Jon L. Luther, Usman Nabi, Richard W. Neu, Robert B. Trussell, Jr. and Tempur Sealy International, Inc., filed July 21, 2017.

During July 2017, three putative shareholder derivative suits were filed against the Company, each member of its Board of Directors and two of its officers. Each complaint alleges that the Board of Directors and officers caused the Company to make materially false and misleading statements regarding its business and financial prospects, including those with one of its retailers, Mattress Firm, which was a violation of the fiduciary duties they owed to the Company. The Company does not believe any of the suits have merit and intends to vigorously defend against the claims in each case. The Plaintiffs in each of the cases have agreed to stay their respective actions until after a decision is rendered on the Motion to Dismiss in the Buehring action noted above. These cases are in the early stages of litigation. As a result, the outcome of each case is unclear and the Company is unable to reasonably estimate the possible loss or range of loss, if any.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(c) Mattress Firm, Inc. v. Tempur-Pedic North America, LLC and Sealy Mattress Company, filed March 30, 2017, and a related matter.

On March 30, 2017, a suit was filed against Tempur-Pedic and Sealy Mattress (two wholly-owned subsidiaries of the Company) in the District Court of Harris County, Texas (the "Texas State Court Case") by Mattress Firm. The complaint alleges breach of contract and tortious interference and seeks a declaratory judgment with respect to the interpretation of its agreements with the Company. On April 7, 2017, the Company's subsidiaries named above filed suit against Mattress Firm in the U.S. District Court for the Southern District of Texas, Houston Division (the "Federal Court Case") seeking injunctive relief and damages for trademark infringement, unfair competition and trademark dilution in violation of the Lanham Act, and breach of contract and other state law violations. The complaint alleges that Mattress Firm violated the parties' transition agreements dated January 30, 2017, and consequently, federal and state law, by its use of the Company's trademarks after April 3, 2017. On April 28, 2017, the complaint was amended to add a claim by Sealy Mattress for nonpayment by Mattress Firm for products sold and delivered. On May 23, 2017, the complaint was further amended to add allegations that Mattress Firm continued to use the Company's trade names and trademarks on its website and in advertising in an inappropriate manner. On July 11, 2017, the Court in the Federal Court Case issued a preliminary injunction prohibiting Mattress Firm from using the Company's names and marks in such manner.

Discovery is complete in the Federal Court Case, and Motions for Summary Judgment on certain claims filed by both parties in early 2018 were ruled on by the court during June and July 2018. A trial date was set for October 10, 2018, but all Mattress Firm litigation was stayed on October 5, 2018 when Mattress Firm filed for bankruptcy under Chapter 11 of the Bankruptcy Code. The Company expects the Federal Court Case to continue to trial upon Mattress Firm's exit from bankruptcy.

The discovery period in the Texas State Court case was extended, and the trial date initially set for September 2018 was reset for early 2019. Discovery was proceeding in the case until Mattress Firm's bankruptcy filing on October 5, 2018 when the litigation was stayed. The Company expects discovery to be restarted in the Texas State Court Case and for it to proceed to trial following Mattress Firm's exit from bankruptcy.

The Company does not believe the claims asserted by Mattress Firm in either case have merit and intends to vigorously defend against them. The outcomes of the cases remain unclear and the Company is unable to reasonably estimate the possible loss or range of loss, if any. Accordingly, the Company can give no assurance that these matters will not have a material adverse effect on the Company's financial position or results of operations.

(d) Other. The Company is involved in various other legal and administrative proceedings incidental to the operations of its business. The Company believes that the outcome of all such other pending proceedings in the aggregate will not have a material adverse effect on its business, financial condition, liquidity, or operating results.

(11) Income Taxes

On December 22, 2017, the President signed the U.S. Tax Reform Act into law. The provisions of the U.S. Tax Reform Act are effective for the Company's year beginning January 1, 2018. As such, the income tax rate for the three and nine months ended September 30, 2018 reflects the impact of the provisions of the U.S. Tax Reform Act.

The Company's effective tax rate for the three months ended September 30, 2018 and 2017 was 26.1% and 28.3%, respectively. The Company's effective tax rate for the nine months ended September 30, 2018 and 2017 was 26.3% and 30.1% respectively. The Company's income tax rate for the three and nine months ended September 30, 2018 and

2017 differed from the U.S. federal statutory rates of 21.0% and 35.0%, respectively, principally due to subpart F income (for the nine months ended September 30, 2018 subpart F income is primarily due to global intangible low-taxed income ("GILTI") earned by the Company's foreign subsidiaries), changes in the Company's uncertain tax positions, related valuation allowances as described more fully below, and certain other permanent items. The Company accounts for the GILTI tax in the period in which such tax arises.

The impact of the U.S. Tax Reform Act has been reflected in the Company's U.S. federal and state income tax returns the Company filed during the quarter ended September 30, 2018. The estimated impact of the U.S. Tax Reform Act as filed by the Company within its federal and state income tax returns has been reflected within the Company's income tax provision for the three and nine month periods ended September 30, 2018 and remains provisional. The Company will continue to assess the impact of the U.S. Tax Reform Act and will record adjustments through the income tax provision in the relevant period as authoritative guidance is made available to the public. Accordingly, the impact of the U.S. Tax Reform Act may ultimately differ from the impact reflected in the Company's U.S. federal and state income tax returns and income tax provision due to and among other factors, information currently not available, changes in interpretations and the issuance of additional guidance, as well as changes in assumptions the Company has currently made, including actions the Company may take in future periods as a result of the U.S. Tax Reform Act.

The Company has been involved in a dispute with the Danish Tax Authority ("SKAT") regarding the royalty paid by a U.S. subsidiary of Tempur Sealy International to a Danish subsidiary (the "Danish Tax Matter"). The royalty is paid by the U.S. subsidiary for the right to utilize certain intangible assets owned by the Danish subsidiary in the U.S. production process.

With respect to the Danish Tax Matter, the Company has received income tax assessments from SKAT for the tax years 2001 through 2008 (the "Danish Assessments") asserting the royalties paid by the U.S. to the Danish subsidiary were too low, which the Company has disputed. In its assessments, SKAT asserts that the amount of royalty paid annually (reflected as a royalty rate) by the U.S. subsidiary to the Danish subsidiary is not reflective of an arm's-length transaction. Accordingly, the tax assessments received from SKAT were based, in part, on a 20% royalty rate, which is substantially higher than that historically used or deemed appropriate by the Company. The Company expected SKAT to continue issuing income tax assessments for tax years 2009 and thereafter reflecting SKAT's view that a 20% royalty rate was appropriate.

During the three month period ended September 30, 2018, the Company reached agreements with both SKAT and the U.S. Internal Revenue Service ("IRS") to settle the Danish Tax Matter for tax years 2001 to 2011 (the "Settlement Years"). The agreement to resolve the Settlement Years is hereinafter referred to as the "Settlement". The terms of the Settlement reflected the amount of the Danish liability for tax and interest that was previously accrued by the Company as an uncertain income tax position. At September 30, 2018, the Danish liability related to the Settlement (i.e., approximately DKK 835.0 million; approximately \$130.0 million using the September 30, 2018 exchange rate) is included in accrued expenses and other current liabilities within the Company's Condensed Consolidated Balance Sheet. It is anticipated that SKAT will issue the Company final tax assessments for each of the Settlement Years within the next twelve month period reflecting the Settlement, at which time the liability will be extinguished. The deferred tax asset representing the U.S. correlative benefit related to the Settlement was \$46.3 million. The Company had previously recorded a valuation allowance related to such deferred tax asset of approximately \$19.3 million. The Company realized the beneficial impact of the Settlement in its U.S. federal and state income tax returns for 2017 (which the Company filed in the quarter ended September 30, 2018). As such, the full correlative relief related to the Settlement was reflected in the Company's 2017 U.S. federal and state income tax liabilities. As a result, the associated valuation allowance was released and reflected as a benefit within the Company's income tax provision for the three month period ended September 30, 2018.

At September 30, 2018, the Company also had accrued Danish tax and interest for tax years subsequent to 2011 (the "Post-2011 Years") of approximately DKK 221.0 million (\$34.4 million using the September 30, 2018 exchange

rates) as an uncertain income tax liability. The amount accrued is included in other non-current liabilities on the Company's Condensed Consolidated Balance Sheet at September 30, 2018. The deferred tax asset for the U.S. correlative benefit associated with the accrual of Danish tax for the Post-2011 Years is approximately \$8.4 million. The Post-2011 Years are subject to further negotiation as part of an Advance Pricing Agreement request ("APA") the Company filed with the IRS on October 26, 2018. In the APA process, the IRS will negotiate the matter for the Post-2011 Years directly with SKAT. The negotiation process is not expected to conclude in the near term.

At December 31, 2017, the Company had accrued Danish tax and interest for the Danish Tax Matter of approximately DKK 854.7 million (approximately \$137.8 million using the December 31, 2017 exchange rate) as an uncertain income tax position. Approximately DKK 835.0 million (approximately \$134.8 million using December 31, 2017 exchange rate) represents the amount accrued with respect to the Settlement Years. The balance of approximately DKK 19.7 million (approximately \$3.2 million using the December 31, 2017 exchange rates) are accrued for the Post-2011 Years. The amount accrued at December 31, 2017 was included in other non-current liabilities on the Company's Consolidated Balance Sheet. In addition, at December 31, 2017, the Company had recorded a deferred tax asset for the U.S. correlative benefit related to the Danish Tax Matter of approximately \$48.3 million. At December 31, 2017, the Company maintained a valuation allowance with respect to this benefit (specifically related to the Settlement Years) of approximately \$19.3 million as it was more likely than not that this portion of the deferred tax asset would not be realized. The gross deferred tax asset was netted with the Company's U.S. deferred tax liabilities in non-current liabilities in the Company's Condensed Consolidated Balance Sheet at December 31, 2017.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The Company's uncertain income tax position associated with the Danish Tax Matter is derived using the cumulative probability analysis with possible outcomes based on the Company's updated evaluation of the facts and circumstances regarding this matter and applying the technical requirements applicable to U.S., Danish, and international transfer pricing standards as required by GAAP, taking into account both the U.S. and Danish income tax implications of such outcomes. Both the uncertain income tax position and the deferred tax asset discussed herein reflects the Company's best judgment of the facts, circumstances and information available through September 30, 2018.

If the Company is not successful in resolving the Danish Tax Matter for the Post-2011 Years or there is a change in facts and circumstances, the Company may be required to further increase its uncertain income tax position associated with this matter, or decrease its deferred tax asset, also related to this matter, which could have a material impact on the Company's reported earnings.

From June 2012 through September 30, 2018, SKAT withheld Value Added Tax refunds otherwise owed to the Company, pending resolution of the Danish Tax Matter. Total withheld refunds at September 30, 2018 and December 31, 2017 are approximately DKK 392.6 million and DKK 336.5 million, respectively, (the "VAT Withheld Refund," approximately \$61.1 million and \$54.1 million using the applicable exchange rates). In July 2016, the Company paid a deposit to SKAT in the amount of approximately DKK 615.2 (approximately \$95.8 million and \$98.9 million using the applicable exchange rates) (the "Tax Deposit") and applied approximately DKK 220.7 million (approximately \$34.4 million and \$35.6 million using the applicable exchange rates) of its Value Added Tax refund (the "VAT Refund Applied") to the aforementioned Danish tax liability related to the Settlement. The deposit was made to mitigate additional interest and foreign exchange exposure. At September 30, 2018, the Tax Deposit and the VAT Refund Applied are included in "Prepaid expenses and other current assets" in the Company's Condensed Consolidated Balance Sheet. At December 31, 2017, the Tax Deposit and the VAT Refund Applied are included in other non-current assets in the Company's Condensed Consolidated Balance Sheets. The balance of the VAT Withheld Refund, approximately DKK 171.9 million (approximately \$26.8 million using the September 30, 2018 exchange rate) may be refunded in the future or applied to the Danish tax liability for the Post-2011 Years (as may ultimately be agreed upon with SKAT as part of the negotiation of the Post-2011 Years).

The amount of unrecognized tax benefits that would impact the effective tax rate if recognized at September 30, 2018 and December 31, 2017 would be \$84.5 million and \$31.7 million (exclusive of interest and penalties and translated at the applicable exchange rates, respectively). There were no other significant changes to the liability for unrecognized income tax benefits during the three months ended September 30, 2018, other than those items discussed herein. Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. It is reasonably possible that there could be material changes to the amount of uncertain income tax positions due to activities of the taxing authorities, settlement of audit issues, reassessment of existing uncertain tax positions, including the Danish tax matter, or the expiration of applicable statute of limitations; however, the Company is not able to estimate the impact of these items at this time.

(12) Earnings Per Common Share

The following table sets forth the components of the numerator and denominator for the computation of basic and diluted earnings per share for net income attributable to Tempur Sealy International.

	Three Months Ended	Nine Months Ended
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	September 30,		September 30,	
(in millions, except per common share amounts)	2018	2017	2018	2017
Numerator:				
Income from continuing operations, net of loss attributable to non-controlling interest	\$45.0	\$56.6	\$99.1	\$116.0
Denominator:				
Denominator for basic earnings per common share-weighted average shares	54.5	54.0	54.4	54.0
Effect of dilutive securities:				
Employee stock-based compensation	0.6	0.9	0.6	0.6
Denominator for diluted earnings per common share-adjusted weighted average shares	55.1	54.9	55.0	54.6
Basic earnings per common share for continuing operations	\$0.83	\$1.05	\$1.82	\$2.15
Diluted earnings per common share for continuing operations	\$0.82	\$1.03	\$1.80	\$2.13

The Company excluded 1.4 million and 1.1 million shares issuable upon exercise of outstanding stock options for the three months ended September 30, 2018 and 2017, respectively, from the diluted earnings per common share computation because their exercise price was greater than the average market price of Tempur Sealy International's common stock or they were otherwise anti-dilutive. The Company excluded 1.5 million and 1.3 million shares issuable upon exercise of outstanding stock options for the nine months ended September 30, 2018 and 2017, respectively, from the diluted earnings per common share computation because their exercise price was greater than the average market price of Tempur Sealy International's common stock or they were otherwise anti-dilutive. Holders of non-vested stock-based compensation awards do not maintain voting rights or maintain rights to receive any dividends thereon.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(13) Business Segment Information

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

The Company's North America and International segment assets include investments in subsidiaries that are appropriately eliminated in the Company's accompanying Condensed Consolidated Financial Statements. The remaining inter-segment eliminations are comprised of intercompany accounts receivable and payable.

The following table summarizes total assets by segment:

(in millions)	September 30, December 31,	
	2018	2017
North America	\$ 2,880.5	\$ 2,771.9
International	596.0	593.8
Corporate	665.1	614.9
Inter-segment eliminations	(1,342.0)	(1,302.2)
Discontinued operations	9.1	15.6
Total assets	\$ 2,808.7	\$ 2,694.0

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

(in millions)	September 30, December 31,	
	2018	2017
North America	\$ 317.0	\$ 320.0
International	51.0	53.1
Corporate	53.0	60.4
Total property, plant and equipment, net	\$ 421.0	\$ 433.5

The following table summarizes segment information for the three months ended September 30, 2018:

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Net sales	\$ 595.8	\$ 133.7	\$ —	\$ —	\$ 729.5
Inter-segment sales	\$ 1.1	\$ 0.2	\$ —	\$ (1.3)	\$ —
Inter-segment royalty expense (income)	0.9	(0.9)	—	—	—
Gross profit	229.2	70.8	—	—	300.0
Operating income (loss)	81.9	25.8	(23.0)	—	84.7
Income (loss) from continuing operations before income taxes	78.5	23.5	(42.3)	—	59.7
Depreciation and amortization ⁽¹⁾	\$ 16.6	\$ 3.3	\$ 10.0	\$ —	\$ 29.9
Capital expenditures	11.2	2.9	1.2	—	15.3

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

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The following table summarizes segment information for the three months ended September 30, 2017:

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Net sales	\$ 580.6	\$ 130.9	\$ —	\$ —	\$ 711.5
Inter-segment sales	\$ 0.9	\$ 0.4	\$ —	\$ (1.3)	\$ —
Inter-segment royalty expense (income)	1.5	(1.5)	—	—	—
Gross profit	238.4	68.6	—	—	307.0
Operating income (loss)	99.7	23.5	(25.9)	—	97.3
Income (loss) from continuing operations before income taxes	97.0	22.0	(44.8)	—	74.2
Depreciation and amortization ⁽¹⁾	\$ 13.1	\$ 3.6	\$ 10.0	\$ —	\$ 26.7
Capital expenditures	9.3	1.7	6.4	—	17.4

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

The following table summarizes segment information for the nine months ended September 30, 2018:

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Net sales	\$1,608.6	\$ 418.2	\$ —	\$ —	\$ 2,026.8
Inter-segment sales	\$2.3	\$ 0.4	\$ —	\$ (2.7)	\$ —
Inter-segment royalty expense (income)	2.2	(2.2)	—	—	—
Gross profit	616.7	220.8	—	—	837.5
Operating income (loss)	200.1	75.5	(77.2)	—	198.4
Income (loss) from continuing operations before income taxes	193.7	71.0	(134.0)	—	130.7
Depreciation and amortization ⁽¹⁾	\$43.8	\$ 10.2	\$ 30.8	\$ —	\$ 84.8
Capital expenditures	42.1	8.9	4.8	—	55.8

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

The following table summarizes segment information for the nine months ended September 30, 2017:

(in millions)	North America	International	Corporate	Eliminations	Consolidated
Net sales	\$1,688.3	\$ 380.9	\$ —	\$ —	\$ 2,069.2
Inter-segment sales	\$3.1	\$ 0.7	\$ —	\$ (3.8)	\$ —
Inter-segment royalty expense (income)	4.4	(4.4)	—	—	—
Gross profit	651.8	201.3	—	—	853.1
Operating income (loss)	206.9	75.4	(69.2)	—	213.1
Income (loss) from continuing operations before income taxes	210.7	69.5	(125.8)	—	154.4
Depreciation and amortization ⁽¹⁾	\$38.3	\$ 10.5	\$ 19.8	\$ —	\$ 68.6

Capital expenditures	23.1	5.0	15.0	—	43.1
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(1) Depreciation and amortization includes stock-based compensation amortization expense.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

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

(in millions)	September 30, December 31,	
	2018	2017
United States	\$ 349.6	\$ 373.2
Canada	20.4	7.2
Other International	51.0	53.1
Total property, plant and equipment, net	\$ 421.0	\$ 433.5
Total International	\$ 71.4	\$ 60.3

The following table summarizes net sales by geographic region:

(in millions)	Three Months		Nine Months	
	Ended		Ended	
	September 30,	September 30,	September 30,	September 30,
	2018	2017	2018	2017
United States	\$536.8	\$517.8	\$1,454.6	\$1,522.5
Canada	59.0	62.8	154.0	165.8
Other International	133.7	130.9	418.2	380.9
Total net sales	\$729.5	\$711.5	\$2,026.8	\$2,069.2
Total International	\$192.7	\$193.7	\$572.2	\$546.7

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(14) Guarantor/Non-Guarantor Financial Information

The \$450.0 million and \$600.0 million aggregate principal amount of 2023 Senior Notes and 2026 Senior Notes (collectively the "Senior Notes"), respectively, are general unsecured senior obligations of Tempur Sealy International and are fully and unconditionally guaranteed on a senior unsecured basis, jointly and severally, by all of Tempur Sealy International's 100% directly or indirectly owned current and future domestic subsidiaries (the "Combined Guarantor Subsidiaries"), subject to certain exceptions. The foreign subsidiaries (the "Combined Non-Guarantor Subsidiaries") represent the foreign operations of the Company and do not guarantee the Senior Notes. A subsidiary guarantor will be released from its obligations under the applicable indenture governing the Senior Notes when: (a) the subsidiary guarantor is sold or sells all or substantially all of its assets; (b) the subsidiary is declared "unrestricted" under the applicable indenture governing the Senior Notes; (c) the subsidiary's guarantee of indebtedness under the 2016 Credit Agreement (as it may be amended, refinanced or replaced) is released (other than a discharge through repayment); or (d) the requirements for legal or covenant defeasance or discharge of the applicable indenture have been satisfied. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions, including transactions with the Company's wholly-owned subsidiary guarantors and non-guarantor subsidiaries. The Company has accounted for its investments in its subsidiaries under the equity method.

The following supplemental financial information presents the Condensed Consolidated Statements of Income and Comprehensive Income for the three and nine months ended September 30, 2018 and 2017, the Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 for Tempur Sealy International, Combined Guarantor Subsidiaries and Combined Non-Guarantor Subsidiaries.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended September 30, 2018

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$ —	\$ 556.6	\$ 197.4	\$ (24.5)	\$ 729.5
Cost of sales	—	338.6	114.1	(23.2)	429.5
Gross profit	—	218.0	83.3	(1.3)	300.0
Selling and marketing expenses	2.2	98.2	48.1	(2.6)	145.9
General, administrative and other expenses	4.6	56.3	13.8	(1.5)	73.2
Equity income in earnings of unconsolidated affiliates	—	—	(3.8)	—	(3.8)
Operating (loss) income	(6.8)	63.5	25.2	2.8	84.7
Other expense, net:					
Third party interest expense, net	14.9	7.8	1.1	(0.2)	23.6
Intercompany interest (income) expense, net	(1.7)	3.3	(1.6)	—	—
Interest expense (income), net	13.2	11.1	(0.5)	(0.2)	23.6
Other (income) expense, net	—	(1.5)	2.5	0.4	1.4
Total other expense, net	13.2	9.6	2.0	0.2	25.0
Income (loss) from equity investees	57.8	(14.9)	—	(42.9)	—
Income from continuing operations before income taxes	37.8	39.0	23.2	(40.3)	59.7
Income tax benefit (provision)	3.6	18.8	(38.1)	0.1	(15.6)
Income (loss) from continuing operations	41.4	57.8	(14.9)	(40.2)	44.1
Loss from discontinued operations, net of tax	—	—	—	(2.7)	(2.7)
Net income (loss) before non-controlling interest	41.4	57.8	(14.9)	(42.9)	41.4
Less: Net loss attributable to non-controlling interest	(0.9)	(0.8)	(0.1)	0.9	(0.9)
Net income (loss) attributable to Tempur Sealy International, Inc.	\$ 42.3	\$ 58.6	\$ (14.8)	\$ (43.8)	\$ 42.3
Comprehensive income (loss) attributable to Tempur Sealy International, Inc.	\$ 44.7	\$ 58.6	\$ (12.4)	\$ (46.2)	\$ 44.7

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Three Months Ended September 30, 2017

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$ —	\$ 520.2	\$ 222.8	\$ (31.5)	\$ 711.5
Cost of sales	—	300.4	130.4	(26.3)	404.5
Gross profit	—	219.8	92.4	(5.2)	307.0
Selling and marketing expenses	1.4	101.7	52.3	(3.4)	152.0
General, administrative and other expenses	4.9	42.4	23.7	(4.5)	66.5
Equity income in earnings of unconsolidated affiliates	—	—	(3.5)	—	(3.5)
Royalty income, net of royalty expense	—	(5.3)	—	—	(5.3)
Operating (loss) income	(6.3)	81.0	19.9	2.7	97.3
Other expense, net:					
Third party interest expense, net	14.8	6.7	10.5	(9.9)	22.1
Intercompany interest (income) expense, net	(1.1)	2.8	(1.7)	—	—
Interest expense, net	13.7	9.5	8.8	(9.9)	22.1
Other (income) expense, net	—	(4.5)	5.6	(0.1)	1.0
Total other expense, net	13.7	5.0	14.4	(10.0)	23.1
Income from equity investees	53.8	1.7	—	(55.5)	—
Income from continuing operations before income taxes	33.8	77.7	5.5	(42.8)	74.2
Income tax benefit (provision)	7.4	(23.9)	(3.8)	(0.7)	(21.0)
Income from continuing operations	41.2	53.8	1.7	(43.5)	53.2
Loss from discontinued operations, net of tax	—	—	—	(12.0)	(12.0)
Net income before non-controlling interest	41.2	53.8	1.7	(55.5)	41.2
Less: Net loss attributable to non-controlling interest	(3.4)	—	(3.4)	3.4	(3.4)
Net income attributable to Tempur Sealy International, Inc.	\$ 44.6	\$ 53.8	\$ 5.1	\$ (58.9)	\$ 44.6
Comprehensive income attributable to Tempur Sealy International, Inc.	\$ 54.2	\$ 54.0	\$ 14.6	\$ (68.6)	\$ 54.2

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Nine Months Ended September 30, 2018

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$ —	\$ 1,507.6	\$ 594.3	\$ (75.1)	) \$ 2,026.8
Cost of sales	—	918.0	338.5	(67.2)	) 1,189.3
Gross profit	—	589.6	255.8	(7.9)	) 837.5
Selling and marketing expenses	6.3	296.5	152.0	(10.2)	) 444.6
General, administrative and other expenses	14.3	154.0	42.5	(4.8)	) 206.0
Equity income in earnings of unconsolidated affiliates	—	—	(11.5)	) —	(11.5)
Operating (loss) income	(20.6)	) 139.1	72.8	7.1	198.4
Other expense, net:					
Third party interest expense, net	44.7	22.3	4.2	(1.7)	) 69.5
Intercompany interest (income) expense, net	(5.3)	) 7.8	(2.5)) —	—
Interest expense, net	39.4	30.1	1.7	(1.7)	) 69.5
Other (income) expense, net	—	(7.1)	) 7.4	(2.1)	) (1.8)
Total other expense, net	39.4	23.0	9.1	(3.8)	) 67.7
Income from equity investees	134.1	15.1	—	(149.2)) —
Income from continuing operations before income taxes	74.1	131.2	63.7	(138.3)	) 130.7
Income tax benefit (provision)	11.3	2.9	(48.6)	) —	(34.4)
Income from continuing operations	85.4	134.1	15.1	(138.3)	) 96.3
Loss from discontinued operations, net of tax	—	—	—	(10.9)	) (10.9)
Net income before non-controlling interest	85.4	134.1	15.1	(149.2)	) 85.4
Less: Net loss attributable to non-controlling interest	(2.8)	) (2.6)	) (0.2)	) 2.8	(2.8)
Net income attributable to Tempur Sealy International, Inc.	\$ 88.2	\$ 136.7	\$ 15.3	\$ (152.0)	) \$ 88.2
Comprehensive income attributable to Tempur Sealy International, Inc.	\$ 78.9	\$ 136.1	\$ 6.6	\$ (142.7)) \$ 78.9

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Statements of Income and Comprehensive Income

Nine Months Ended September 30, 2017

(in millions)

	Tempur Sealy International Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
Net sales	\$ —	\$ 1,522.4	\$ 641.2	\$ (94.4)	\$ 2,069.2
Cost of sales	—	920.9	375.3	(80.1)	1,216.1
Gross profit	—	601.5	265.9	(14.3)	853.1
Selling and marketing expenses	4.2	308.9	148.3	(10.0)	451.4
General, administrative and other expenses	13.8	132.2	60.5	(6.7)	199.8
Customer termination charges, net	(8.4)	21.8	1.0	—	14.4
Equity income in earnings of unconsolidated affiliates	—	—	(10.6)	—	(10.6)
Royalty income, net of royalty expense	—	(15.0)	—	—	(15.0)
Operating (loss) income	(9.6)	153.6	66.7	2.4	213.1
Other expense, net:					
Third party interest expense, net	44.7	19.4	12.1	(10.8)	65.4
Intercompany interest (income) expense, net	(3.6)	5.6	(2.0)	—	—
Interest expense, net	41.1	25.0	10.1	(10.8)	65.4
Other (income) expense, net	—	(13.6)	5.2	1.7	(6.7)
Total other expense, net	41.1	11.4	15.3	(9.1)	58.7
Income from equity investees	129.1	33.6	—	(162.7)	—
Income from continuing operations before income taxes	78.4	175.8	51.4	(151.2)	154.4
Income tax benefit (provision)	16.5	(46.7)	(17.8)	1.5	(46.5)
Income from continuing operations	94.9	129.1	33.6	(149.7)	107.9
Loss from discontinued operations, net of tax	—	—	—	(13.0)	(13.0)
Net income before non-controlling interest	94.9	129.1	33.6	(162.7)	94.9
Less: Net loss attributable to non-controlling interest	(8.1)	—	(8.1)	8.1	(8.1)
Net income attributable to Tempur Sealy International, Inc.	\$ 103.0	\$ 129.1	\$ 41.7	\$ (170.8)	\$ 103.0
Comprehensive income attributable to Tempur Sealy International, Inc.	\$ 130.1	\$ 124.6	\$ 73.4	\$ (198.0)	\$ 130.1

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

Supplemental Condensed Consolidated Balance Sheets

September 30, 2018

(in millions)

	Tempur Sealy International, Inc. (Ultimate Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Reclassifications and Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	\$ —	\$ 10.5	\$ 22.9	\$ (1.3)	) \$ 32.1
Accounts receivable, net	—	12.8	352.1	9.2	) 374.1
Inventories	—	160.8	61.6	(1.9)	) 220.5
Prepaid expenses and other current assets	274.3	97.0	147.0	(275.0)	) 243.3
Current assets of discontinued operations	—	—	—	7.6	) 7.6
Total Current Assets	274.3	281.1	583.6	(261.4)	) 877.6
Property, plant and equipment, net	—	349.6	72.4	(1.0)	) 421.0
Goodwill	—	508.8	218.0	(0.3)	) 726.5
Other intangible assets, net	—	575.8	81.3	(0.1)	) 657.0
Deferred income taxes	12.7	—	22.8	(12.7)	) 22.8
Other non-current assets	—	51.9	50.5	(0.1)	) 102.3
Net investment in subsidiaries	645.6	215.1	—	(860.7)) —
Due from affiliates	420.1	127.2	25.4	(572.7)) —
Non-current assets of discontinued operations	—	—	—	1.5	) 1.5
Total Assets	\$ 1,352.7	\$ 2,109.5	\$ 1,054.0	\$ (1,707.5)	) \$ 2,808.7
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Accounts payable	\$ —	\$ 196.0	\$ 61.3	\$ 9.3	) \$ 266.6
Accrued expenses and other current liabilities	21.4	150.2	207.2	(2.8)	) 376.0
Income taxes payable	—	270.4	15.6	(274.8)	) 11.2
Current portion of long-term debt	—	40.2	32.8	—	) 73.0
Current liabilities of discontinued operations	—	—	—	6.9	) 6.9
Total Current Liabilities	21.4	656.8	316.9	(261.4)	) 733.7
Long-term debt, net					