

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

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

FORM 10-K

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

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

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

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

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

Act. Yes No

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

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

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

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

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

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE

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

TABLE OF CONTENTS

	Page
PART I.	
ITEM 1.	
	1
	1
	1
	3
	3
	4
	4
	5
	5
	5
	6
	6
ITEM 1A.	
	7
ITEM 1B.	
	15
ITEM 2.	
	15
ITEM 3.	
	16
ITEM 4.	
	17
PART II.	
ITEM 5.	
	17
ITEM 6.	
	20
ITEM 7.	
	22
	22
	23
	23
	29

	<u>Factors That May Affect Future Performance</u>	33
	<u>Critical Accounting Policies and Estimates</u>	34
	<u>Impact of Recently Issued Accounting Pronouncements</u>	36
ITEM 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	36
	<u>Foreign Currency Exposures</u>	36
	<u>Interest Rate Risk</u>	36
ITEM 8.	<u>Financial Statements and Supplementary Data</u>	37
ITEM 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	37
ITEM 9A.	<u>Controls and Procedures</u>	37
	<u>Evaluation of Disclosure Controls and Procedures</u>	37
	<u>Management’s Annual Report on Internal Control Financial Reporting</u>	37
	<u>Changes in Internal Control Over Financial Reporting</u>	37
	<u>Report of Independent Registered Public Accounting Firm</u>	38
ITEM 9B.	<u>Other Information</u>	39
PART III.		
ITEM 10.	<u>Directors and Executive Officers of the Registrant</u>	39
ITEM 11.	<u>Executive Compensation</u>	40
ITEM 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	40
ITEM 13.	<u>Certain Relationships and Related Transactions and Director Independence</u>	40
ITEM 14.	<u>Principal Accountant Fees and Services</u>	40
PART IV.		
ITEM 15.	<u>Exhibits and Financial Statement Schedules</u>	41
	<u>Signatures</u>	45

Special Note Regarding Forward-Looking Statements

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

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

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

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

Table of Contents

PART I

ITEM 1. BUSINESS

General

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

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

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

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

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

Market Opportunity and Competitive Strengths

Global Market

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

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

1

Table of Contents

Our Market Position

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

Superior Product Offerings

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

Increasing Global Brand Awareness

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

Vertically Integrated Manufacturing and Supply Chain

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

Strong Financial Performance

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

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

2

Table of Contents

Significant Growth Opportunities

We believe there are significant opportunities to take market share from the innerspring mattress industry as well as other sleep surfaces. Our market share of the overall mattress industry is relatively small in terms of both dollars and units, which we believe provides us with a significant opportunity for growth. By expanding our brand awareness and offering superior sleep surfaces, we believe consumers will continue to adopt our products at an increasing rate, which should expand our market share. As of December 31, 2007, our products were sold in approximately 6,350 furniture