TEMPUR SEALY INTERNATIONAL, INC.
Form 10-Q
November 08, 2013

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

FORM 10-Q

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

For the quarterly period ended September 30, 2013

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

For the transition period from
to

Commission file number 001-31922

TEMPUR 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 ý No o

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

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

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of the registrant's common stock as of November 6, 2013 was 60,485,184 shares.

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Special Note Regarding Forward-Looking Statements

This quarterly report on Form 10-Q, including the information incorporated by reference herein, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which includes information concerning our plans; objectives; goals; strategies; future events; future revenues or performance; the impact of the macroeconomic environment in both the U.S. and internationally on sales and our business segments; strategic long-term investments; changes in capital expenditures; consumer confidence and the availability of consumer financing; changes in interest rates; litigation and similar issues; changes in foreign tax rates and changes in tax laws generally, including the ability to utilize tax loss carry forwards; the outcome of pending tax audits or other tax proceedings; financial flexibility; the impact of initiatives to respond to increased levels of competition in our industry; the impact of initiatives to accelerate growth, expand market share and attract sales; efforts to expand business within established accounts, improve account productivity, reduce costs and operating expenses and improve manufacturing productivity; changing commodity costs; initiatives to improve gross margin; the vertical integration of our business; the development, rollout and market acceptance of new products; the efficiency and effectiveness of our advertising campaigns and other marketing programs; our ability to further invest in the business and in brand awareness; our ability to meet financial obligations and continue to comply with the terms of our credit facilities, including financial ratio covenants; effects of changes in foreign exchange rates on our reported earnings; our expected sources of cash flow; our ability to effectively manage cash; our ability to align costs with sales expectations; and our ability to successfully integrate Sealy Corporation ("Sealy") into the Company's operations and realize cost and revenue synergies and other benefits from the transaction, including expectations regarding product offerings, growth opportunities, value creation, and financial strength. Many of these statements appear, in particular, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in ITEM 2 of Part I of this report. When used in this report, the words "estimates," "expects," "anticipates," "projects," "proposed," "plans," "intends," "believes" and variations of such w 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. There are important factors, many of which are beyond the Company's control, that could cause our actual results to differ materially from those expressed as forward-looking statements in this report, including the risk factors discussed under the heading "Risk Factors" under ITEM IA of Part II of this report and under the heading "Risk Factors" under ITEM 1A of Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2012 and under the heading "Risk Factors" under ITEM IA of Part II of our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2013 and June 30, 2013. 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.

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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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales	$735.5	$347.9	$1,786.2	$1,061.8
Cost of sales	436.8	176.8	1,044.2	517.8
Gross profit	298.7	171.1	742.0	544.0
Selling and marketing expenses	150.9	76.2	377.1	243.2
General, administrative and other expenses	71.9	31.5	206.9	103.8
Equity income in earnings of unconsolidated affiliates	(1.2)	—	(2.5)	—
Royalty income, net of royalty expense	(4.1)	—	(9.2)	—
Operating income	81.2	63.4	169.7	197.0
Other expense, net:				
Interest expense, net	24.6	4.8	88.2	13.0
Other expense (income), net	0.9	(0.4)	4.0	(0.4)
Total other expense	25.5	4.4	92.2	12.6
Income before income taxes	55.7	59.0	77.5	184.4
Income tax provision	(15.5)	(61.0)	(26.9)	(101.1)
Net income (loss) before non-controlling interest	40.2	(2.0)	50.6	83.3
Less: Net (loss) attributable to non-controlling interest	—	—	(0.5)	—
Net income (loss) attributable to Tempur Sealy International, Inc.	$40.2	$(2.0)	$51.1	$83.3
Earnings (loss) per common share:				
Basic	$0.66	$(0.03)	$0.85	$1.34
Diluted	$0.65	$(0.03)	$0.83	$1.31
Weighted average common shares outstanding:				
Basic	60.5	59.6	60.3	62.1
Diluted	61.6	59.6	61.6	63.6

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 Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss) including non-controlling interest	$40.2	$(2.0)	$50.6	$83.3
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	9.4	5.5	(8.3)	1.0
Net change in unrecognized gain (loss) on interest rate swap	—	(0.5)	1.1	(1.4)
Other comprehensive income, net of tax	9.4	5.0	(7.2)	(0.4)
Comprehensive income	49.6	3.0	43.4	82.9
Less: Comprehensive loss attributable to non-controlling interest	—	—	(0.5)	—
Comprehensive income attributable to Tempur Sealy International, Inc.	$49.6	$3.0	$43.9	$82.9

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, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$126.6	$179.3
Accounts receivable, net	349.3	129.8
Inventories, net	182.8	93.0
Receivable from escrow	—	375.0
Prepaid expenses and other current assets	52.7	41.4
Deferred income taxes	39.2	2.6
Total Current Assets	750.6	821.1
Property, plant and equipment, net	411.6	186.0
Goodwill	756.4	216.1
Other intangible assets, net	758.2	63.1
Deferred income taxes	9.7	10.4
Other non-current assets	75.0	16.3
Total Assets	$2,761.5	$1,313.0
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$181.7	$85.8
Accrued expenses and other current liabilities	220.4	81.4
Deferred income taxes	0.5	26.5
Income taxes payable	33.0	15.5
Current portion of long-term debt	39.7	—
Total Current Liabilities	475.3	209.2
Long-term debt	1,820.4	1,025.0
Deferred income taxes	287.2	31.4
Other non-current liabilities	85.2	25.1
Total Liabilities	2,668.1	1,290.7
Commitments and contingencies—see Note 12		
Redeemable non-controlling interest	10.9	—
Total Stockholders' Equity	82.5	22.3
Total Liabilities and Stockholders' Equity	$2,761.5	$1,313.0

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, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income before non-controlling interest	$50.6	$83.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	52.5	26.9
Amortization of stock-based compensation	13.8	3.7
Amortization of deferred financing costs	5.0	1.0
Write-off of deferred financing costs	4.7	—
Bad debt expense	0.1	1.7
Deferred income taxes	(56.4)	36.6
Equity income in earnings of unconsolidated affiliates	(2.3)	—
Non cash interest expense on convertible notes	2.4	—
Loss on sale of assets	0.6	—
Foreign currency adjustments and other	—	1.6
Changes in operating assets and liabilities	33.8	(1.2)
Net cash provided by operating activities	104.8	153.6
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of business, net of cash acquired	(1,172.9)	(3.9)
Purchases of property, plant and equipment	(28.4)	(38.4)
Other	0.9	—
Net cash used in investing activities	(1,200.4)	(42.3)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from 2012 Credit Agreement	2,917.6	—
Repayments of 2012 Credit Agreement	(1,559.1)	—
Proceeds from issuance of Senior Notes	375.0	—
Proceeds from 2011 Credit Facility	46.5	284.5
Repayments of 2011 Credit Facility	(696.5)	(220.0)
Proceeds from issuance of common stock	6.0	10.6
Excess tax benefit from stock based compensation	3.7	9.7
Treasury shares repurchased	—	(152.6)
Payments of deferred financing costs	(52.0)	(0.1)
Other	(0.7)	(2.5)
Net cash provided by (used in) financing activities	1,040.5	(70.4)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	2.4	(0.6)
(Decrease) increase in cash and cash equivalents	(52.7)	40.3
CASH AND CASH EQUIVALENTS, beginning of period	179.3	111.4
CASH AND CASH EQUIVALENTS, end of period	$126.6	$151.7

Supplemental cash flow information:

Cash paid during the period for:		
Interest	$65.9	$11.9
Income taxes, net of refunds	$33.1	$56.6

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 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® brands, technology and trademarks to other manufacturers. Additionally, the Company participates in several joint ventures in the Asia Pacific region as well as a joint venture in the U.S. with Comfort Revolution International, LLC ("Comfort Revolution"), a distributor and manufacturer of specialty foam and gel bedding products. The Company sells its products through three sales channels: Retail, Direct and Other.

On March 18, 2013, the Company completed the acquisition of Sealy Corporation and its historical subsidiaries (“Sealy”), which manufactures and markets a broad range of mattresses and foundations under the Sealy®, Sealy Posturepedic®, Optimum ™ and Stearns & Foster® brands. The Company’s acquisition of Sealy is more fully described in Note 2, “Business Combination”. The results of operations for Sealy are reported within the Company’s Sealy reportable segment and includes results from March 18, 2013 to September 30, 2013 in the Company’s results for the nine months ended September 30, 2013. In connection with the acquisition, the Company borrowed $1,900.0 million in aggregate principal to fund the purchase price and to repay all outstanding borrowings under the 2011 Credit Facility, which is described in Note 4, “Debt”.

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

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and include all of the information and disclosures required by generally accepted accounting principles in the United States (“U.S. GAAP” or “GAAP”) for interim financial reporting. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Company and related footnotes for the year ended December 31, 2012, included in the Company’s Annual Report on Form 10-K and Current Report on Form 8-K filed April 1, 2013 and related amendments filed on June 3, 2013 and July 12, 2013.

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

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

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

(in millions)	September 30, 2013	December 31, 2012
Finished goods	$118.9	$68.5
Work-in-process	10.8	7.9
Raw materials and supplies	53.1	16.6
	$182.8	$93.0

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(d) Accrued Sales Returns. The Company allows product returns through certain sales channels and on certain products. Estimated sales returns are provided at the time of sale based on historical sales channel return rates. Estimated future obligations related to these products are provided by a reduction of sales in the period in which the revenue is recognized. Accrued sales returns are included in accrued expenses and other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

The Company had the following activity for sales returns from December 31, 2012 to September 30, 2013:

(in millions)	
Balance as of December 31, 2012	$5.1
Amounts accrued	74.0
Liabilities assumed as result of acquisition	19.9
Returns charged to accrual	(70.5)
Balance as of September 30, 2013	$28.5

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

The following summarizes the Company's warranty terms:

Segment	Product/Brand	Warranty Term (in years)
Tempur North America	Mattresses	25, prorated (1)
Tempur North America	Pillows	3
Tempur International	Mattresses	15, prorated (1)
Tempur International	Pillows	3
Sealy	Mattresses	10 - 25, prorated(2)

(1) The last 10 years of warranty period are prorated on a straight-line basis.

(2) Products have various warranty terms, generally non-prorated for the first 10 to 15 years and then prorated for the balance of the warranty term.

The Company had the following activity for warranties from December 31, 2012 to September 30, 2013:

(in millions)	
Balance as of December 31, 2012	$4.8
Amounts accrued	15.6
Liabilities assumed as a result of acquisition	21.4
Warranties charged to accrual	(15.2)
Balance as of September 30, 2013	$26.6

As of September 30, 2013 and December 31, 2012, $16.3 million and $1.9 million are included as a component of accrued expenses and other current liabilities and $10.3 million and $2.9 million are included in other non-current liabilities on the Company's accompanying Condensed Consolidated Balance Sheets, respectively. In estimating its warranty obligations, the Company considers the impact of recoverable salvage value on warranty costs by segment in determining its estimate of future warranty obligations. As as a result of adjustments to the preliminary allocation of the purchase price related to the acquisition of Sealy, the Company increased the liabilities assumed as a result of acquisition.

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

The allowance for doubtful accounts is the Company’s best estimate of the amount of probable credit losses in the Company’s existing accounts receivable. The Company regularly reviews the adequacy of its allowance for doubtful accounts. The Company determines the allowance based on historical write-off experience and current economic conditions. It also considers factors such as customer credit, past transaction history with the customer and changes in customer payment terms when determining whether the collection of a receivable is reasonably assured. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the potential for recovery is considered remote. The allowance for doubtful accounts included in accounts receivable, net in the accompanying Condensed Consolidated Balance Sheets was $20.9 million and $8.2 million as of September 30, 2013 and December 31, 2012, respectively.

(g) Research and Development Expenses. Research and development expenses for new products are expensed as they are incurred and included in general, administrative and other expenses in the accompanying Condensed Consolidated Statements of Income. Research and development costs charged to expense were $5.4 million and $3.9 million for the three months ended September 30, 2013 and 2012, respectively. Research and development costs charged to expense were $14.8 million and $11.1 million for the nine months ended September 30, 2013 and 2012, respectively.

(h) Royalty Income and Expense. The Company recognizes royalty income based on sales of Sealy® and Stearns & Foster® branded products by various licensees. The Company also pays royalties to other entities for the use of their names on products produced by the Company. These amounts are not material for the three and nine months ended September 30, 2013.

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

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

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(2) Business Combination

On March 18, 2013, the Company completed the acquisition of Sealy ("Sealy Acquisition"). Pursuant to the merger agreement, each share of common stock of Sealy issued and outstanding immediately prior to the effective time of the Sealy Acquisition was cancelled and (other than shares held by Sealy or Tempur-Pedic or their subsidiaries or Sealy stockholders who properly exercised their appraisal rights) converted into the right to receive $2.20 in cash. The total purchase price was $1,172.9 million, which was funded using available cash and financing consisting of the Company's 2012 Credit Agreement and Senior Notes (see Note 4, "Debt" for the definition of these terms and further discussion). The purchase price of Sealy consisted of the following items:

(in millions)		
Cash consideration for stock	$231.2	(1)
Cash consideration for share-based awards	14.2	(2)
Cash consideration for 8.0% Sealy Notes	442.1	(3)
Cash consideration for repayment of Sealy Senior Notes	260.7	(4)
Cash consideration for repayment of Sealy 2014 Notes	276.9	(5)
Total consideration	1,225.1	
Cash acquired	(52.2)	(6)
Net consideration transferred	$1,172.9	

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

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

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

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

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

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

The Company incurred $1.2 million and $18.4 million of direct transaction costs for the three and nine months ended September 30, 2013, respectively. These costs are included in general, administrative and other expenses in the accompanying Condensed Consolidated Statements of Income. In addition, the Company incurred $19.9 million of incremental interest expense for the nine months ended September 30, 2013, which includes interest and other fees on the Senior Notes and the 2012 Credit Agreement for the period prior to March 18, 2013, commitment fees associated with financing for the closing of the Sealy Acquisition, and the write off of deferred financing costs associated with the 2011 Credit Facility.

Sealy, headquartered in Trinity, North Carolina, owns one of the largest portfolios of bedding brands in the world, and manufactures and markets a complete line of bedding products under the Sealy®, Sealy Posturepedic®, Optimum™

and Stearns & Foster® brands. The results of operations of Sealy and Sealy’s historical subsidiaries are reported within the Company’s Sealy reportable segment.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

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

(in millions)	
Accounts receivable	$186.1
Inventory	75.1
Prepaid expenses and other current assets	39.3
Accounts payable	(77.9)
Accrued expenses	(134.2)
Property, plant and equipment	242.3
Other assets	36.9
Identifiable intangible assets:	
Indefinite-lived trade names	521.2
Contractual retailer/distributer relationships	91.1
Developed technology, including patents	87.1
Customer databases	3.9
Optimum™ trade name	2.3
Deferred income taxes, net	(246.9)
Sealy 8.0% Notes	(96.2)
Redeemable non-controlling interest	(11.3)
Other liabilities	(87.1)
Goodwill	541.2
Net consideration transferred	$1,172.9

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

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

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

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

The Company is amortizing the identifiable intangible assets, other than the indefinite-lived trade name, on a straight-line basis over the weighted average lives ranging from 5 to 15 years.

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TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

The table below sets forth the preliminary valuation and amortization period of identifiable intangible assets:
($ in millions)

	Preliminary Valuation	Amortization Period
Identifiable intangible assets:		
Trade names	$521.2	Indefinite
Contractual retailer/distributor relationships	91.1	15 years
Developed technology, including patents	87.1	10 years
Customer databases	3.9	5 years
Optimum™ trade name	2.3	5 years
Total	$705.6	

The Company estimated the preliminary fair value of the acquired property, plant and equipment using a combination of the cost and market approaches, depending on the component. The preliminary fair value of property, plant and equipment consisted of real property of $101.0 million and personal property of $141.3 million.

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

The following unaudited pro forma information presents the combined financial results for the Company and Sealy as if the Sealy Acquisition had been completed at the beginning of the Company's prior year, January 1, 2012. Prior to the Sealy Acquisition, Sealy used a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. Accordingly, the pro forma information set forth below for the three months ended September 30, 2012 includes Sealy's pro forma information for the quarterly period May 28, 2012 through August 26, 2012. The pro forma financial information set forth below for the nine months ended September 30, 2013 includes Sealy's pro forma information for the combined nine month period from December 3, 2012 through March 3, 2013 and April 1, 2013 through September 29, 2013 and the nine month period November 28, 2011 through August 26, 2012, respectively.

(in millions, except earnings per common share)	Three Months Ended September 30,	Nine Months Ended September 30,	
	2012	2013	2012
Net sales	$713.4	$2,079.1	$2,051.6
Net (loss) income	$(1.8)	$62.7	$52.5
(Loss) earnings from continuing operations per common share – Diluted	$(0.03)	$1.02	$0.86

The information above does not include the pro forma adjustments that would be required under Regulation S-X for pro forma financial information, and does not reflect future events that may occur after September 30, 2013 or any operating efficiencies or inefficiencies that may result from the Sealy Acquisition and related financing. Therefore, the information is not necessarily indicative of results that would have been achieved had the businesses been combined during the periods presented or the results that the Company will experience going forward.

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(3) Goodwill and Other intangible assets

During the nine months ending September 30, 2013, the Company's goodwill increased by approximately $541.2 million related to the Sealy Acquisition. This amount is subject to change based upon the finalization of the allocation of the consideration transferred to the assets acquired and liabilities assumed related to Sealy.

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

(in millions)	Total	Tempur North America	Tempur International	Sealy
Balance as of December 31, 2012	$216.1	$108.9	$107.2	$—
Goodwill resulting from acquisitions	541.2	—	—	541.2
Foreign currency translation adjustments	(0.9)	(0.6)	(0.3)	—
Balance as of September 30, 2013	$756.4	$108.3	$106.9	$541.2

The following table summarizes information relating to the Company's other intangible assets, net:
($ in millions)

		September 30, 2013			December 31, 2012		
	Useful Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Unamortized indefinite life intangible assets:							
Trade name		$575.5	$—	$575.5	$55.0	$—	$55.0
Amortized intangible assets:							
Contractual distributor relationships	15	$90.7	$3.3	$87.4	$—	$—	$—
Technology	10	90.1	20.0	70.1	16.0	16.0	—
Patents, other trademarks, & other trade names	5-20	29.7	11.5	18.2	12.9	9.9	3.0
Customer database	5	8.7	5.2	3.5	4.9	4.9	—
Foam formula	10	3.7	3.7	—	3.7	3.7	—
Reacquired rights	3	5.6	5.6	—	5.8	5.3	0.5
Customer relationships	5	6.7	3.2	3.5	6.7	2.1	4.6
Total		$810.7	$52.5	$758.2	$105.0	$41.9	$63.1

Amortization expense relating to intangible assets for the Company was $4.3 million and $1.4 million for the three months ended September 30, 2013 and 2012, respectively. Amortization expense relating to intangible assets for the Company was $10.5 million and $4.3 million for the nine months ended September 30, 2013 and 2012, respectively. No impairments of goodwill or other intangible assets have adjusted the gross carrying amount of these assets in any historical period.

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(4) Debt

Debt. Debt for the Company consists of the following:

(in millions)	September 30, 2013	December 31, 2012
Debt:		
$375.0 million Senior Notes, interest at 6.875%, due December 15, 2020	$375.0	$375.0
Revolving credit facility, interest at Base Rate plus applicable margin, 2.25% or LIBOR plus applicable margin, 3.25% as of September 30, 2013, commitment through and due March 18, 2018	90.0	—
Term A Facility, interest at Base Rate plus applicable margin 1.5%, or LIBOR plus applicable margin, 2.5% as of September 30, 2013, commitment through and due March 18, 2018	529.4	—
Term B Facility, interest at Base Rate plus applicable margin 1.75%, or LIBOR plus applicable margin, 2.75% as of September 30, 2013, commitment through and due March 18, 2020	739.1	—
8.0% Sealy Notes, due July 15, 2016	98.4	—
Capital lease obligations and other	28.2	—
2011 Domestic long-term revolving credit facility payable to lenders, interest at Base Rate or LIBOR plus applicable margin (2.05% as of December 31, 2012), extinguished as of March 18, 2013	—	650.0
	$1,860.1	$1,025.0
Less current portion	(39.7)	—
	$1,820.4	$1,025.0

Senior Notes

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

Tempur Sealy International has the option to redeem all or a portion of the Senior Notes at any time on or after December 15, 2016. Starting on this date the initial redemption price is 103.438% of the principal amount, plus accrued and unpaid interest, if any. The redemption price will decline to 101.719% on December 15, 2017 and to 100.0% of the principal amount beginning on December 15, 2018. In addition, Tempur Sealy International has the option at any time prior to December 15, 2016 to redeem some or all of the Senior Notes at 100.0% of the original principal amount plus a "make-whole" premium and accrued and unpaid interest, if any. Tempur Sealy International may also redeem up to 35.0% of the Senior Notes prior to December 15, 2015, under certain circumstances with the net cash proceeds from certain equity offerings, at 106.875% of the principal amount plus accrued and unpaid interest, if any. Tempur Sealy International may make such redemptions only if, after any such redemption, at least 65.0% of the original aggregate principal amount of the Senior Notes issued remains outstanding.

The Indenture restricts the ability of Tempur Sealy International and the ability of certain of its subsidiaries to, among other things: (i) incur, directly or indirectly, debt; (ii) make, directly or indirectly, certain investments and restricted payments; (iii) incur or suffer to exist, directly or indirectly, liens on its properties or assets; (iv) sell or otherwise dispose of, directly or indirectly, assets; (v) create or otherwise cause or suffer to exist any consensual restriction on the right of certain of the subsidiaries of Tempur Sealy International to pay dividends or make any other distributions on or in respect of their capital stock; (vi) enter into transactions with affiliates; (vii) engage in sale-leaseback transactions; (viii) purchase or redeem capital stock or subordinated indebtedness; (ix) issue or sell stock of restricted subsidiaries; and (x) effect a consolidation or merger. These covenants are subject to a number of exceptions and qualifications.

Also in conjunction with the issuance and sale of the Senior Notes, Tempur Sealy International and the Guarantors agreed through a Registration Rights Agreement to exchange the Senior Notes for a new issue of substantially identical senior notes registered under the Securities Act. Tempur Sealy International and the Guarantors would have been required to pay additional interest if the Senior Notes were not registered within the time periods specified within the Registration Rights Agreement. Tempur Sealy International filed a registration statement on Form S-4 on July 12, 2013 in connection with the registration of the Senior Notes, and the registration statement was declared effective by Securities and Exchange Commission on July 26, 2013, which was within the specified time period.

As a result of the Company’s issuance of the Senior Notes, $8.3 million of deferred financing costs were capitalized and are being amortized over seven years using the effective interest method.

2012 Credit Agreement

On December 12, 2012, Tempur Sealy International and certain subsidiaries of Tempur Sealy International as borrowers and guarantors, entered into a credit agreement (the “2012 Credit Agreement”) with a syndicate of banks. The 2012 Credit Agreement initially provided for (i) a revolving credit facility of $350.0 million (the “Revolver”), (ii) a term A facility of $550.0 million (the “Term A Facility”) and (iii) a term B facility of $870.0 million (the “Term B Facility”). The Revolver includes a sublimit for letters of credit and swingline loans, subject to certain conditions and limits. The Revolver and the Term A Facility will mature on March 18, 2018 and the Term B Facility will mature on March 18, 2020. The Revolver, the Term A Facility and the Term B Facility closed and funded in connection with the Sealy Acquisition on March 18, 2013. In the first and second quarters of 2013, the outstanding balance of the Term A Facility and the Term B Facility were reduced by regularly scheduled payments. Additionally, on May 16, 2013, the outstanding balance of the Term B Facility was reduced by a voluntary prepayment of $125.0 million. After giving effect to $90.0 million in borrowings under the revolver portion of the 2012 Credit Agreement and letters of credit outstanding of $22.4 million, total availability under the revolver was $237.6 million as of September 30, 2013.

Borrowings under the 2012 Credit Agreement will generally bear interest, at the election of Tempur Sealy International and the other borrowers, at either (i) LIBOR plus the applicable margin or (ii) Base Rate plus the applicable margin. For the Revolver and the Term A Facility, (a) the initial applicable margin for LIBOR advances was 3.00% per annum and the initial applicable margin for Base Rate advances was 2.00% per annum, and (b) thereafter following the delivery of financial statements for the first full fiscal quarter after closing, such applicable margins will be determined by a pricing grid based on the consolidated total net leverage ratio of the Company. The Term B Facility was initially subject to a LIBOR floor of 1.0%. The applicable margin was initially 4.00% per annum for LIBOR advances and 3.00% per annum for Base Rate advances. On May 16, 2013, the applicable margin on the Term B Facility was reduced to 3.00% per annum and the LIBOR floor was reduced by 0.75% until maturity. On July 11, 2013, the applicable margin on the Term A Facility was reduced by 0.75% for each pricing level on the pricing grid based on the consolidated total net leverage ratio of the Company.

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Obligations under the 2012 Credit Agreement are guaranteed by Tempur Sealy International's existing and future direct and indirect wholly-owned domestic subsidiaries, subject to certain exceptions; and the 2012 Credit Agreement is secured by a security interest in substantially all Tempur Sealy International's and the other borrowers' domestic assets and the domestic assets of each subsidiary guarantor, whether owned as of the closing or thereafter acquired, including a pledge of 100.0% of the equity interests of each subsidiary guarantor that is a domestic entity (subject to certain limited exceptions) and 65.0% of the voting equity interests of any direct first tier foreign entity owned by a subsidiary guarantor. The 2012 Credit Agreement requires compliance with certain financial covenants providing for maintenance of a minimum consolidated interest coverage ratio and maintenance of a maximum consolidated total net leverage ratio. The consolidated total net leverage ratio is calculated using consolidated funded debt less qualified cash. Consolidated funded debt includes debt recorded on the Condensed Consolidated Balance Sheets as of the reporting date, plus letters of credit outstanding and short-term other debt. The Company is allowed to exclude 100.0% of the domestic qualified cash 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, 2013, domestic qualified cash was $62.0 million and foreign qualified cash was $38.8 million.

The 2012 Credit Agreement contains certain customary negative covenants, which include limitations on liens, investments, indebtedness, dispositions, mergers and acquisitions, the making of restricted payments, changes in the nature of business, changes in fiscal year, transactions with affiliates, use of proceeds, prepayments of certain indebtedness, entry into burdensome agreements and changes to governing documents and other junior financing documents. The 2012 Credit Agreement also contains certain customary affirmative covenants and events of default, including upon a change of control.

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

The Company is in compliance with all applicable covenants at September 30, 2013.

8.0% Sealy Notes

In conjunction with the Sealy Acquisition, Sealy's obligations under its 8.0% Sealy Notes were amended. As a result of the Sealy Acquisition, the 8.0% Sealy Notes became convertible solely into cash, in an amount that declined slightly every day during the Make-Whole Period (as defined under the Supplemental Indenture governing the 8.0% Sealy Notes) that followed the Sealy Acquisition, and then became fixed thereafter. The Make-Whole Period effectively expired on April 12, 2013. As of April 12, 2013, approximately 83.0% of all the 8.0% Sealy Notes outstanding prior to the Sealy Acquisition were converted into cash and paid to the holders. Holders of the 8.0% Sealy Notes who converted on March 19, 2013 received approximately $2,325.43 per $1,000 Accreted Principal Amount of the 8.0% Sealy Notes being converted. The holders of the 8.0% Sealy Notes who convert after April 12, 2013 will receive $2,200 per $1,000 Accreted Principal Amount of the 8.0% Sealy Notes being converted. The Company calculated the preliminary fair value of the remaining 8.0% Sealy Notes as part of its preliminary purchase price allocation by first calculating the future payout of the remaining 17.0% aggregate principal amount of the 8.0% Sealy Notes still outstanding and the cumulative semi-annual interest payments at the July 15, 2016 maturity, and then calculated the present value using a market discount rate, which resulted in a fair value of $96.2 million at the date of the opening balance sheet. As of September 30, 2013, the fair value of the 8.0% Sealy Notes are $98.6 million, which includes

$2.4 million of accreted discount. The discount is accreted through non-cash interest expense over the life of the 8.0% Sealy Notes using the effective interest method. As of September 30, 2013, the 8.0% Sealy Notes had a carrying value of $98.4 million, which includes $2.4 million of accreted discount less conversion payments made to holders of certain 8.0% Sealy Notes that were tendered for conversion.

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

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

Capital Leases

As a result of the Sealy Acquisition, the Company is party to capital leases and has recorded the preliminary fair value of the obligation on its condensed balance sheet as of March 18, 2013, the acquisition date. The approximate remaining life of the leases is 10 years.

2011 Credit Facility

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

Deferred Financing Costs

As a result of the Company’s issuance of the Senior Notes and in conjunction with entering into the 2012 Credit Agreement, $54.3 million of deferred financing costs were capitalized and will be amortized as interest expense over the respective debt instrument period, ranging from five to eight years, using the effective interest method.

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

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

Interest Rate Swap

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

(5) Unconsolidated Affiliate Companies

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

(6) Fair Value Measurements

The classification of fair value measurements within the established three-level hierarchy is based upon the lowest level of input that is significant to the measurement. There were no transfers between levels for the three or nine months ended September 30, 2013. At September 30, 2013, the Company had an interest rate swap recorded at fair value. The fair value of the interest rate swap is calculated using standard industry models based on observable forward yield curves. The Company also utilizes foreign currency forward contracts to manage the risk associated with exposures to foreign currency risk related to intercompany debt and associated interest payments. The foreign currency forward contracts are not material to the accompanying Condensed Consolidated Financial Statements. The fair values of all derivative instruments are adjusted for credit risk and restrictions and other terms specific to the contracts.

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

(in millions)		Fair Value Measurements at September 30, 2013 Using:		
	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swap	$ 2.8	$—	$2.8	$ —

(in millions)		Fair Value Measurements at December 31, 2012 Using:		
	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Interest rate swap	$ 4.3	$—	$4.3	$ —

The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term maturity of those instruments. Borrowings under the 2012 Credit Agreement are at variable interest rates and accordingly their carrying amounts approximate fair value. The fair value of the Senior Notes was approximately $391.9 million at September 30, 2013. The fair value of the Sealy 8.0% Notes was approximately $98.6 million at September 30, 2013.
(7) Derivative Financial Instruments

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

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

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

As of September 30, 2013 and December 31, 2012, the fair value of the Company's derivative instruments included in the accompanying Condensed Consolidated Balance Sheets were recorded as follows:
(in millions)

	Liability Derivatives		
	Balance Sheet Location	Fair Value	
		September 30, 2013	December 31, 2012
Derivatives designated as hedging instruments			
Interest rate swap - current	Accrued expenses and other current liabilities	$1.7	$2.3
Interest rate swap - non-current	Other non-current liabilities	1.1	2.0
		$2.8	$4.3

(8) Stockholders' Equity

Tempur Sealy International's authorized shares of capital stock are 300.0 million shares of common stock and 0.01 million shares of preferred stock. 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 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.
(9) Defined Benefit Plans

As of September 30, 2013, the Company's liability related to its sponsored defined benefit plans acquired with the Sealy Acquisition was $12.2 million. The net periodic pension cost for the period March 18 through September 30, 2013 was not material.

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(10) Other Items

(a) Property, plant and equipment. Property, plant and equipment, net consisted of the following:

(in millions)

	September 30, 2013	December 31, 2012
Land and buildings	$263.6	$138.0
Machinery and equipment	259.9	160.9
Computer equipment and software	69.8	52.5
Furniture and fixtures	56.6	40.8
Construction in progress	23.5	17.3
	673.4	409.5
Accumulated depreciation	(261.8)	(223.5)
	$411.6	$186.0

(b) Accrued expenses and other current liabilities. Accrued expenses and other current liabilities consisted of the following:
(in millions)

	September 30, 2013	December 31, 2012
Wages and Benefits	$54.8	$18.7
Advertising	28.8	10.5
Sales Returns	28.5	5.1
Rebates	18.0	4.1
Warranty	16.3	1.9
Interest	8.7	0.5
Freight	6.3	2.5
Professional Fees	4.6	5.3
Sales and VAT Tax	4.2	7.0
Insurance	3.8	0.9
Other	46.4	24.9
	$220.4	$81.4

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(c) Accumulated other comprehensive income. On January 1, 2013, the Company adopted changes issued by the Financial Accounting Standards Board to the reporting of amounts reclassified out of accumulated other comprehensive income. These changes require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures that provide additional detail about those amounts. These requirements are to be applied to each component of accumulated other comprehensive income. Other than the additional disclosure requirements (as described below), the adoption of these changes had no impact on the accompanying Condensed Consolidated Financial Statements.

The changes in accumulated other comprehensive income by component consisted of the following:
(in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Foreign Currency Translation				
Balance at beginning of period	$(22.6)	$(17.7)	$(4.9)	$(13.2)
Other comprehensive (loss) income:				
Foreign currency translation adjustments (1)	9.4	5.5	(8.3)	1.0
Balance at end of period	$(13.2)	$(12.2)	$(13.2)	$(12.2)
Interest Rate Swap				
Balance at beginning of period	$(1.6)	$(2.5)	$(2.7)	$(1.6)
Other comprehensive (loss) income:				
Net change from period revaluations:	0.8	1.3	4.0	1.4
Tax (expense)(2)	—	(0.5)	(1.1)	(0.5)
Total other comprehensive income before reclassifications, net of tax	$0.8	$0.8	$2.9	$0.9
Net amount reclassified to earnings (3)	(0.8)	(1.6)	(2.4)	(3.2)
Tax benefit (2)	—	0.3	0.6	0.9
Total amount reclassified from accumulated other comprehensive loss, net of tax	$(0.8)	$(1.3)	$(1.8)	$(2.3)
Total other comprehensive (loss) income	—	(0.5)	1.1	(1.4)
Balance at end of period	$(1.6)	$(3.0)	$(1.6)	$(3.0)

(1) In all periods presented, there were no tax impacts related to rate changes and no amounts were reclassified to earnings.

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

(3) This amount was included in interest expense, net on the accompanying Condensed Consolidated Statements of Income.

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(11) Stock-Based Compensation

The Company’s stock-based compensation expense for the three and nine months ended September 30, 2013 included performance-based restricted stock units (“PRSUs”), non-qualified stock options, RSUs and DSUs. A summary of the Company’s stock-based compensation expense is presented below:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
PRSU expense (benefit)	$1.6	$(5.2)	$3.6	$(1.1)
Option expense	2.1	1.0	6.3	3.2
RSU/DSU Expense	1.9	0.5	3.9	1.6
Total stock based compensation expense (benefit)	$5.6	$(3.7)	$13.8	$3.7

A summary of the Company’s PRSU activity and related information for the nine months ended September 30, 2013 is presented below:

(shares in millions)	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Awards outstanding at December 31, 2012	0.3	$58.52	
Granted	0.3	39.34	
Vested	—	—	
Forfeited	(0.3)	56.92	
Awards outstanding at September 30, 2013	0.3	$39.04	$11.0

The maximum number of shares to be awarded under the PRSUs granted during the three and nine months ended September 30, 2013 will be 0.6 million and will vest, if earned, at the end of the two-year performance period ending on December 31, 2014.

During the nine months ended September 30, 2013, PRSUs with an aggregate intrinsic value of $14.9 million were issued from treasury stock following the satisfaction of certain financial metrics over the performance period. The PRSUs were issued from treasury stock at 282.0% of the target award, out of a maximum payout of 300.0%.

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A summary of the Company's stock option activity and related information for the nine months ended September 30, 2013 is presented below:

(shares in millions)

	Number of Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options outstanding December 31, 2012	2.9	$17.00		
Granted	0.6	39.71		
Forfeited	(0.1)	39.38		
Exercised	(0.5)	13.14		
Options outstanding at September 30, 2013	2.9	$21.60	6.20	$60.4
Options exercisable at September 30, 2013	2.0	$14.51	4.70	$59.7

The aggregate intrinsic value of options exercised during the three months ended September 30, 2013 and 2012 was $1.1 million and $0.1 million, respectively. The aggregate intrinsic value of options exercised during the nine months ended September 30, 2013 and 2012 was $13.4 million and $32.2 million, respectively.

A summary of the Company's RSU and DSU activity and related information for the three and nine months ended September 30, 2013 is presented below:

(shares in millions)

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Awards outstanding at December 31, 2012	0.2	$32.03	
Granted	0.2	45.56	
Vested	(0.2)	29.59	
Forfeited	—	—	
Awards outstanding at September 30, 2013	0.2	$46.98	$9.1

The RSUs granted during the three and nine months ended September 30, 2013 will vest over one to two year periods, varying by the terms of each grant. DSUs granted during the nine months ended September 30, 2013 will vest over one year.

The aggregate intrinsic value of RSUs issued from treasury stock during the nine months ended September 30, 2013 was $6.4 million.

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A summary of total unrecognized stock-based compensation expense based on current performance estimates related to the PRSUs, options and RSUs/DSUs granted during the nine months ended September 30, 2013 is presented below:

($ in millions)

	September 30, 2013	Weighted Average Remaining Vesting Period (Years)
Unrecognized PRSU expense	$6.3	0.73
Unrecognized stock option expense	6.3	1.39
Unrecognized RSU/DSU expense	4.7	1.01
Total unrecognized stock-based compensation expense	$17.3	1.04

(12) Commitments and Contingencies

(a) Purchase Commitments. The Company will, from time to time, enter into limited purchase commitments for the purchase of certain raw materials. Amounts committed under these programs are not significant as of September 30, 2013 and December 31, 2012.

(b) Norfolk County Retirement System, Individually and on behalf of all others similarly situated, Plaintiff v. Tempur-Pedic International Inc., Mark A. Sarvary and Dale E. Williams; filed June 20, 2012

Arthur Benning, Jr., Individually and on behalf of all others similarly situated, Plaintiff v. Tempur-Pedic International Inc., Mark A. Sarvary and Dale E. Williams; filed June 25, 2012

On June 20 and 25, 2012, the above suits were filed against the Company and two named executive officers in the United States District Court for the Eastern District of Kentucky, purportedly on behalf of a proposed class of shareholders who purchased the Company's stock between January 25, 2012 and June 5, 2012. The complaints assert claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, alleging, among other things, false and misleading statements and concealment of material information concerning the Company's competitive position, projected net sales, earnings per diluted share and related financial performance for the Company's 2012 fiscal year. The plaintiffs seek damages, interest, costs, attorney's fees, expert fees and unspecified equitable/injunctive relief. The Company strongly believes that the shareholder suits lack merit and intends to defend against the claims vigorously. The outcome of these matters is uncertain, however, and although the Company does not currently expect to incur a loss with respect to these matters, the Company cannot currently predict the manner and timing of the resolution of the suits, an estimate of a range of losses or any minimum loss that could result in the event of an adverse verdict in these suits, or whether the Company's applicable insurance policies will provide sufficient coverage for these claims. 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.

(c) Sealy Mattress Company of JY, Inc., David Hertz, individually, as trustee of, respectively, the Allison Lindsay Hertz Trust, the Samuel Douglas Hertz Trust, the Sydney Lauren Hertz Trust, the U/A DTD 08/21/97 Andrew Michael Marcus Trust, the U/A DTD 08/21/97 Julia Robyn Marcus Trust, and the U/A DTD 08/21/97 James Daniel Marcus Trust, and as executor of the Estate of Walter Hertz, Lisa Marcus, Rose Naiman, Michael Shoobs, and Diane Shoobs, individually and as custodian of the Robert S. Shoobs UTMA NJ v. Sealy Corporation, filed June 27, 2013.

With respect to the Sealy Acquisition, holders of approximately 3.1 million shares of Sealy common stock sent notices to Sealy purporting to exercise their appraisal rights in accordance with the Merger Agreement executed on September 26, 2012. In order to preserve these appraisal rights, any such former stockholder was required to commence an appraisal proceeding in the Delaware courts within 120 days after March 18, 2013. Sealy has expressly reserved its rights to contest that any or all of such notices were not delivered timely or otherwise not in the form required under Delaware law. On June 27, 2013, an appraisal proceeding was commenced in the Delaware Court of Chancery (the “Appraisal Action”). If the fair value of the Sealy common stock formerly held by the former Sealy stockholders seeking the appraisal is determined to be greater than the $2.20 per share paid pursuant to the Merger Agreement, Sealy would be required to pay such difference, plus interest at the statutory rate, which could impact the Company’s financial condition and liquidity.

TEMPUR SEALY INTERNATIONAL, INC. AND SUBSIDIARIES

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

(d) Michael Dodson, Alvin Todd, and Henry and Mary Thompson, individually and on behalf of all others similarly situated, Plaintiffs v. Tempur Sealy International, Inc., formerly known as Tempur-Pedic International, Inc. and Tempur-Pedic North America, LLC, Defendants; filed October 25, 2013

On October 25, 2013, a suit was filed against Tempur Sealy International and one of its domestic subsidiaries in the United States District Court for the Northern District of California, purportedly on behalf of a proposed class of "consumers" as defined by Cal. Civ. Code § 1761(d) who purchased, not for resale, a Tempur-Pedic mattress or pillow in the State of California. The purported class seeks certification of claims under California law. As of the date of the filing of this quarterly report on Form 10-Q, the complaint has not been served on the Company.

The complaint alleges that the Company engaged in unfair business practices, false advertising, and misrepresentations or omissions related to the sale of certain products. The plaintiffs seek restitution, injunctive relief and all other relief allowed under applicable California law, interest, attorneys' fees and costs. The purported class does not seek damages for physical injuries. The Company believes the case lacks merit and intends to defend against the claims vigorously. This matter is at a very preliminary stage, and the outcome is uncertain. As a result, the Company is unable to reasonably estimate the possible loss or range of losses, if any, arising from this litigation, or whether the Company's applicable insurance policies will provide sufficient coverage for these claims. 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.

(e) Environmental. The Company is currently conducting an environmental cleanup at a formerly owned facility in South Brunswick, New Jersey pursuant to the New Jersey Industrial Site Recovery Act. Sealy and one of its subsidiaries are parties to an Administrative Consent Order issued by the New Jersey Department of Environmental Protection. Pursuant to that order, Sealy and its subsidiary agreed to conduct soil and groundwater remediation at the property. The Company does not believe that its manufacturing processes were the source of contamination. The Company sold the property in 1997. The Company retained primary responsibility for the required remediation. Previously, the Company removed and disposed of contaminated soil from the site with the New Jersey Department of Environmental Protection approval, and the Company has installed a groundwater remediation system on the site. During 2005, with the approval of the New Jersey Department of Environmental Protection, the Company removed and disposed of sediment in Oakeys Brook adjoining the site. The Company continues to monitor ground water at the site. During 2012, with the approval of the New Jersey Department of Environmental Protection, the Company commenced the removal and disposal of additional contaminated soil from the site. The Company has recorded a reserve as a component of other accrued expenses and other noncurrent liabilities in the accompanying Consolidated Balance Sheets as of September 30, 2013 for $2.9 million associated with this remediation project.

The Company has also undertaken a remediation of soil and groundwater contamination at an inactive facility located in Oakville, Connecticut. Although the Company is conducting the remediation voluntarily, it obtained Connecticut Department of Energy and Environmental Protection ("DEEP") approval of the remediation plan. The Company believes that it has essentially completed its remediation of the site. In 2012, the Company submitted separate closure reports to the Connecticut DEEP for the lower portion of the site and the upper portion of the site. The Connecticut DEEP approved the Company's closure report for the upper portion of the site and also gave conditional approval to the Company's closure report for the lower portion of the site. The conditional approval for the lower portion closure requires the Company to perform additional water monitoring on the lower portion of the site to demonstrate compliance with applicable standards. The Company is currently performing that monitoring. The Company has recorded a liability of approximately $0.1 million associated with the completion of the closure of its remediation efforts at the site.The Company believes the contamination is attributable to the manufacturing operations of previous, unrelated, unaffiliated occupants of the facility.

The Company cannot predict the ultimate timing or costs of the South Brunswick and Oakville environmental matters. Based on facts currently known, the Company believes that the accruals recorded are adequate and does not believe the resolution of these matters will have a material effect on the financial position or future operations of the Company. However, in the event of an adverse decision by the agencies involved, or an unfavorable result in the New Jersey natural resources damages matter, these matters could have a material effect on the Company's financial position or results of operations.

In 1998, the Company sold an inactive facility located in Putnam, Connecticut. Recently, the Company received a letter from the attorney for the current owner of that property claiming that the Company may have some responsibility for an environmental condition on the property. The Company continues to investigate the factual background on this matter, but intends to vigorously defend the claim of the current owner against the Company.

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

(13) Income Taxes

The Company's effective tax rate for the three months ended September 30, 2013 and 2012 was 27.8% and 103.4%, respectively. The Company's tax rate for the nine months ended September 30, 2013 and 2012 was 34.7% and 54.8%, respectively. The Company's income tax rate for the three and nine months ended September 30, 2013 and 2012 differed from the U.S. federal statutory rate of 35.0% principally due to changes in estimates related to the tax cost of the Company's foreign earnings repatriation, changes in the Company's uncertain tax positions during the three and nine months ended September 30, 2013, certain foreign tax rate differentials, state and local income taxes, foreign income currently taxable in the U.S., the production activities deduction, certain Sealy Acquisition costs, and certain other permanent differences.

In conjunction with the Sealy Acquisition, in the quarter ended March 31, 2013, the Company repatriated substantially all of its current and accumulated foreign earnings associated with the Tempur North America and Tempur International subsidiaries, in a taxable transaction. The Company had previously tax effected those earnings and at December 31, 2012 had recorded a $48.1 million deferred tax liability on such earnings. As a result of the Sealy Acquisition, the Company recognized the benefit of certain foreign tax credit attributes associated with Sealy's foreign subsidiaries' earnings. These foreign tax credits could not be taken into account in calculating the Company's tax on the book to tax basis difference of its foreign subsidiaries until the Sealy Acquisition closed. As a result of the taxable transaction and taking into consideration the application of these foreign tax credits for the three months ended March 31, 2013, the tax recognized on the repatriation transaction was approximately $37.1 million, based on the preliminary allocation of purchase price related to the Sealy Acquisition. Consequently, the Company recorded an $11.0 million tax benefit for the difference between that tax previously accrued on foreign earnings and the current estimate of taxes payable on the repatriation of such earnings. During the three months ended June 30, 2013, the Company adjusted the tax on the repatriation transaction by approximately $5.5 million as a result of further adjustments to the valuation of Sealy's international business. During the three months ended September 30, 2013, there were no changes in the Company's estimate of the tax due related to the repatriation of the Company's foreign earnings, as described above. Accordingly, the Company has recorded a cumulative total of $42.6 million related to the foreign cash repatriated in connection with the Sealy Acquisition. At September 30, 2013, the tax basis of the Company's investment in its foreign subsidiaries exceeds the Company's basis. Accordingly, no deferred taxes have been recorded related to this basis difference as it is not apparent that the difference will reverse in the foreseeable future.

The Company has received income tax assessments from the Danish Tax Authority ("SKAT") with respect to the tax years 2001 through 2007 relating to the royalty paid by one of Tempur Sealy International's U.S. subsidiaries to a Danish subsidiary. The 2007 income tax assessment was received in May 2013. The cumulative total tax assessment for all years is approximately $200.3 million including interest and penalties. The Company filed timely protests with the Danish National Tax Tribunal (the "Tribunal") challenging the tax assessments. The National Tax Tribunal formally agreed to place the Danish tax litigation on hold pending the outcome of a Bilateral Advance Pricing Agreement ("Bilateral APA") between the United States and SKAT. A Bilateral APA involves an agreement between the Internal Revenue Service ("IRS") and the taxpayer, as well as a negotiated agreement with one or more foreign competent authorities under applicable income tax treaties. During the third quarter of 2008, the Company filed the Bilateral APA with the IRS and SKAT. U.S. and Danish competent authorities have met to discuss the Company's Bilateral APA. SKAT and the IRS met several times since 2011, most recently in February 2013, to discuss the matter. At the conclusion of the February 2013 meeting the IRS and SKAT concluded that a mutually acceptable agreement on the matter could not be reached and, as a result, the Bilateral APA process was terminated. The Company now expects the Tribunal proceedings to be reconvened later in 2013. The Tribunal is a branch of SKAT that is independent of the discussions and negotiations that have taken place to date. If the Tribunal does not rule to the satisfaction of one or both parties, the party seeking redress may choose to litigate the issue in the Danish court system. In the quarter ended September 30, 2013, the Company was notified by SKAT that SKAT has granted a deferral to 2017 of the requirement to post a cash deposit or other form of security for the taxes that have been assessed for the period 2001 through 2007. The Company believes it has meritorious defenses to the proposed adjustments and will oppose the assessments before the Tribunal and in the Danish courts, as necessary. The impact of terminating the Bilateral APA program has been considered by the Company in its September 30, 2013 estimate of uncertain tax benefits. It is reasonably possible the amount of unrecognized tax benefits may change in the next twelve months. An estimate of the amount of such change cannot be made at this time. If the Company is not successful in defending its position before the Tribunal or in the Danish courts, the Company could be required to pay significant amounts to SKAT, which could impair or reduce its liquidity and profitability. During the three months ended September 30, 2013 the Company received correspondence from SKAT requesting information regarding the royalty for the years 2008 through 2011. The correspondence indicated that SKAT would be evaluating the royalty

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paid for each of the years under examination. The Company has responded to SKAT's request for information. As of September 30, 2013 the Company has not been notified of any proposed adjustments with respect to any of the transactions discussed.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. During the three months ended June 30, 2013, the Company concluded the tax examination of the Tempur-Pedic International Inc. U.S. federal income tax return for the years 2008 and 2009. With respect to the Company's income tax returns, in August 2013 the Company was advised by the IRS that the years 2010 and 2011 would not be examined but that 2012 would be examined. That examination has not yet begun. With few exceptions, the Company is no longer subject to tax examinations by the U.S., state, and local municipalities for periods prior to 2006, and in non-U.S. jurisdictions for periods prior to 2001. As it relates to Sealy for years prior to the Sealy Acquisition, Sealy or one of its subsidiaries was required to file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. Sealy's U.S. federal income tax returns and with few exceptions its foreign income tax returns are no longer subject to examination for years prior to 2004. Generally Sealy's state and local jurisdiction income tax returns are no longer subject to examination for years prior to 2000.

Additionally, the Company is currently under examination by various tax authorities around the world. The Company anticipates it is reasonably possible an increase or decrease in the amount of unrecognized tax benefits could be made in the next twelve months as a result of the statute of limitations expiring and/or the examinations being concluded on these returns. However, the Company does not presently anticipate that any increase or decrease in unrecognized tax benefits will be material to the consolidated financial statements. Other than the changes discussed in the preceding paragraph, there were no significant changes to the liability for unrecognized tax benefits during the nine months ended September 30, 2013.

(14) Major Customers

The top five customers accounted for approximately 33.9% and 25.9% of the Company's net sales for the three months ended September 30, 2013 and 2012, respectively. The top five customers accounted for approximately 27.0% and 23.2% of the Company's net sales for the nine months ended September 30, 2013 and 2012, respectively. Net sales from one customer (Mattress Firm Holding Corp.) represented more than 10.0% of net sales for the three and nine months ended September 30, 2013. The top five customers also accounted for approximately 27.2% and 25.3% of accounts receivable as of September 30, 2013 and 2012, respectively.

(15) Earnings Per Common Share

(in millions, except per common share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net income (loss) attributable to Tempur Sealy International, Inc.	$40.2	$(2.0)	$51.1	$83.3
Denominator:				
Denominator for basic earnings per common share-weighted average shares	60.5	59.6	60.3	62.1
Effect of dilutive securities:				

Employee stock-based compensation	1.1	—	1.3	1.5
Denominator for diluted earnings per common share-adjusted weighted average shares	61.6	59.6	61.6	63.6
Basic earnings (loss) per common share	$0.66	$(0.03)	$0.85	$1.34
Diluted earnings (loss) per common share	$0.65	$(0.03)	$0.83	$1.31

The Company excluded 0.3 million shares issuable upon exercise of outstanding stock options for the three months ended September 30, 2013, and 0.3 million and 0.1 million for the nine months ended September 30, 2013 and 2012 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.

(16) Business Segment Information

The Company operates in three business segments: Tempur North America, Tempur International and Sealy. As a result of the Sealy Acquisition, the Company now has a new reportable business segment which represents Sealy's results of operations. These reportable segments are strategic business units that are managed separately based on the fundamental differences in their operations. The Tempur North America segment consists of the two U.S. manufacturing facilities and the Tempur North America distribution subsidiaries. The Tempur International segment consists of the manufacturing facility in Denmark, whose customers include all of the distribution subsidiaries and third party distributors outside the Tempur North America segment. The Sealy segment consists of manufacturing and distribution subsidiaries related to Sealy. The Company evaluates segment performance based on net sales and operating income. The Company includes certain corporate operating expenses in the Tempur North America segment, which were $16.7 million and $8.7 million for the three months ended September 30, 2013 and 2012, respectively. Certain corporate operating expenses included in the Tempur North America segment for the nine months ended September 30, 2013 and 2012, were $67.0 million and $39.1 million, respectively. There were no material allocations of corporate operating expenses to the Tempur International or Sealy segments for the three or nine months ended September 30, 2013 and 2012. The Company's Tempur North America, Tempur International and Sealy segment assets include investments in subsidiaries which are appropriately eliminated in the Company's accompanying Condensed Consolidated Financial Statements. The remaining inter-segment eliminations are comprised of intercompany accounts receivable. The effect of the elimination of the investments in subsidiaries is included in the inter-segment eliminations as shown below.

The following table summarizes total assets by segment:

(in millions)

	September 30, 2013	December 31, 2012
Total assets:		
Tempur North America	$2,098.5	$1,160.4
Tempur International	536.7	504.1
Sealy	1,901.7	—
Investment in subsidiaries	(991.2)	(347.6)
Other intercompany eliminations	(784.2)	(3.9)
	$2,761.5	$1,313.0

The following table summarizes long-lived assets by segment:

(in millions)

	September 30, 2013	December 31, 2012
Long-lived assets:		
Tempur North America	$391.2	$395.7
Tempur International	68.0	69.5
Sealy	1,467.0	—
	$1,926.2	$465.2

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The following table summarizes net sales by geographic region:

(in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
United States	$537.5	$228.0	$1,264.9	$705.0
Canada	64.1	12.9	135.2	31.5
Other International	133.9	107.0	386.1	325.3
	$735.5	$347.9	$1,786.2	$1,061.8
Total International	$198.0	$119.9	$521.3	$356.8

The following table summarizes segment information:
(in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales to external customers:				
Tempur North America				
Bedding	$220.6	$220.1	$624.7	