



FORM 10-K

SEALY CORP - ZZ

Filed: January 15, 2009 (period: November 30, 2008)

Annual report which provides a comprehensive overview of the company for the past year

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

FORM 10-K

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

For the fiscal year ended November 30, 2008

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

For the Transition Period from to

Commission file number 333-117081-27

SEALY CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

36-3284147
(I.R.S. Employer Identification No.)

Sealy Drive
One Office Parkway
Trinity, North Carolina
(Address of principal executive offices)

27370
(Zip Code)

Registrant's telephone number, including area code--(336) 861-3500

Securities registered pursuant to Section 12(b) of the Act:

Table with 2 columns: Title of Each Class, Name of Each Exchange on which Registered. Row 1: Common Stock, par value \$0.01 per share; New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act Yes [] No [X]

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

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

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

Indicated 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 [] Accelerated filer [X] Non-accelerated filer [] Smaller reporting company []
(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates as of June 1, 2008 was \$276,118,725.

The number of shares of the registrant's common stock outstanding as of January 2, 2009 is approximately: 91,806,885.

DOCUMENTS OR PARTS THEREOF INCORPORATED BY REFERENCE:

Portions of the Registrant's proxy statement for the 2009 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K to the extent described herein.

PART I

Item 1. Business

General

Sealy Corporation (hereinafter referred to as the "Company", "Sealy", "we", "our", or "us"), a Delaware corporation organized in 1984, is the largest bedding manufacturer in the world. Based on *Furniture/Today*, a furniture industry publication, we are also the leading bedding manufacturer in the United States with a wholesale market share of approximately 20.9% in 2007, 1.34 times greater than that of our next largest competitor.

We manufacture and market a complete line of bedding products, including mattresses and mattress foundations. Our conventional (innerspring) bedding products are manufactured and marketed in the Americas under our *Sealy*, *Sealy Posturepedic*, *Stearns & Foster* and *Bassett* brand names. In addition, we manufacture and market specialty (non-innerspring) latex and visco-elastic bedding products under the *PurEmbrace*, *TrueForm*, *SpringFree*, *Stearns & Foster*, *Reflexions*, *Carrington Chase*, *MirrorForm* and *Pirelli* brand names, which we sell in the profitable specialty bedding category in the United States and internationally.

We believe that our *Sealy* brand name has been the number one selling brand in the domestic bedding industry for over 25 years and our *Stearns & Foster* brand name is one of the leading brands devoted to the attractive luxury category in the industry. We believe that going to market with the best selling and most recognized brand in the domestic bedding industry (*Sealy*), one of the leading luxury brands (*Stearns & Foster*), and differentiated specialty bedding offerings gives us a competitive advantage and strengthens our relationships with our customers by allowing us to offer sleep solutions to a broad group of consumers.

We maintain an internet website at www.sealy.com. We make available on our website, free of charge, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Proxy Statements, and other reports, as soon as reasonably practicable after they are electronically filed or furnished to the Securities and Exchange Commission ("SEC").

Initial Public Offering of Our Common Stock and Use of Proceeds

On April 12, 2006, we completed an initial public offering ("IPO") of our common stock, raising \$299.2 million of net proceeds after deducting the underwriting discount. We used a portion of the proceeds to pay a cash dividend to shareholders of record immediately prior to the IPO of \$125 million. We also used a portion of the proceeds from the IPO to repurchase and retire \$47.5 million aggregate principal amount of our 8.25% Senior Subordinated Notes due 2014 in a series of open market transactions completed on April 26, 2006 at prices ranging from 105.25% to 105.92% of par, plus accrued interest. On April 21, 2006, we used approximately \$90.0 million of IPO proceeds to redeem the entire outstanding balance of the senior subordinated pay-in-kind notes ("PIK Notes"), along with accrued interest and prepayment penalties through the date of the redemption. For a detailed presentation of the sources and uses of cash from the IPO, see Note 2 to our Consolidated Financial Statements in Item 8.

Merger and Recapitalization

On April 6, 2004, we completed a merger with an affiliate of Kohlberg Kravis Roberts & Co. L.P., which we refer to collectively as KKR, whereby KKR acquired approximately 92% of our capital stock. Certain of our stockholders prior to the merger, including affiliates of Bain Capital, LLC and others, which we refer to collectively as Rollover Stockholders, retained approximately an 8% interest in our stock. In connection with the merger, we recapitalized substantially all of our outstanding debt. At November 30, 2008, KKR controlled approximately 51% of our issued and outstanding common stock.

Our Segments

We have two reportable segments: the Americas and Europe. These segments have been identified and aggregated based on our organizational structure, which is organized around geographic areas. Both of our reportable segments manufacture and market conventional and specialty bedding products. The Americas segment operations are concentrated in the United States, Canada, Mexico, Argentina, Uruguay, Brazil, and Puerto Rico, with our dominant operations being in the United States. Europe operations are concentrated in western Europe. We derived approximately 9.9% of our fiscal 2008 net sales from our Europe segment, with the remainder of our net sales coming from the Americas segment. For more information regarding revenues, income and assets by reportable segment, see Note 19 to our Consolidated Financial Statements in Item 8.

Products

We produce sleep sets across a range of technologies, including innerspring, latex foam and visco-elastic "memory foam", and sell them in diverse geographies in the Americas and Europe. While our strategy is to drive one-third of our sales growth through domestic specialty products, the majority of our products continue to be in the domestic innerspring market where we offer a complete line of innerspring bedding products in sizes ranging from twin to king size, selling at retail price points from under \$300 to approximately \$5,000 per queen set domestically. While we sell conventional products at all retail price points, we focus our product development and sales efforts toward mattress and box spring sets that sell at retail price points above \$750 domestically. Though the higher priced market sectors have shown more of a downturn due to the slowdown of the global economy in 2008, we believe that the higher priced sectors of the market will return to their historical growth trends, offering faster growth and greater profitability in the long-term. For fiscal 2008, we derived approximately 64% of our total domestic sales from products with retail price points of \$750 and above.

Our product development efforts include regular introductions across our lines in order to maintain the competitiveness and the profitability of our products. In the first quarter of fiscal 2007, we introduced a new line of *Stearns & Foster* branded mattresses and box springs. We also introduced a new line of *Posturepedic* Reserve branded mattresses and box springs. These launches were essentially completed in the third quarter of fiscal 2007. In addition, we introduced new *Sealy*-branded products that are compliant with the Federal flame retardant standard, 16 CFR Part 1633 passed by the U.S. Consumer Product Safety Commission, which became effective July 1, 2007.

In January 2008, we unveiled an innovative new *Sealy Posturepedic* innerspring line, which is designed to eliminate tossing and turning caused by pressure points. The line was designed in conjunction with orthopedic surgeons, and reviewed by an independent Orthopedic Advisory Board. These mattresses come in three series: Preferred, Reserve and Signature, and range in retail price points from \$599 to more than \$1,000 per queen set.

In June 2008, we announced the introduction of the *Sealy Posturepedic PurEmbrace* mattress featuring the Company's proprietary *SmartLatex*. The line delivers unsurpassed pressure relief combined with the best of *Sealy Posturepedic* support to eliminate virtually all the uncomfortable pressure points that cause tossing and turning, making it the Company's most advanced sleep system ever. This new latex sleep system aligns with our corporate growth strategy, which focuses, in part, on innovation within the specialty mattress category. As with earlier major product launches, we expect our sales and profitability growth to be limited during the period in which our customers complete the transition to our new product lines.

In the Americas and Europe, we also produce a variety of innovative latex foam, and visco-elastic "memory foam" bedding products for the specialty bedding category. The specialty bedding category has experienced substantial growth in recent years but has taken a downturn during fiscal 2008 along with other luxury priced bedding. These products are often sold with financing terms provided by

retailers that have struggled recently to offer the same terms as those in the past. However, we believe that by successfully leveraging our strong premium brand positions, existing relationships with customers, marketing and distribution capabilities, product development capabilities and latex manufacturing technology, we have been able to gain market share in the specialty bedding category. We believe that the potential to increase market share continues to exist for future periods even with the slowdown of overall bedding sales. We believe this is especially true given our planned expansion of the distribution of our *SmartLatex* products to additional customers in fiscal 2009. Due to continued new specialty product introductions, we have experienced growth in the specialty bedding category from 2006 through 2008 at a combined rate of 42%. In our other international markets within the Americas, we also offer a wide range of products. In each market, we offer a full line of innerspring and specialty products under the *Sealy* and local brand names.

In Europe, we produce, market and distribute latex products that are produced through a proprietary, continuous production process and sold to customers in the European retail market primarily under the *Pirelli* brand name. Additionally, Europe sells latex components to other mattress, furniture and automotive manufacturers worldwide. While our primary focus in Europe is on latex products, we also produce and sell innerspring products within the European retail market.

Customers

Our five largest customers on a consolidated basis accounted for approximately 25.4% of our net sales for fiscal 2008 and no single customer, represented more than 10% of our net sales during fiscal 2008. In the U.S., we serve a large and well diversified base of approximately 3,300 customers, including furniture stores, specialty bedding stores, department stores and warehouse club stores. During 2008, the economic environment became more challenging and caused a higher occurrence of bankruptcies for mattress retailers. It has also caused many of the smaller mattress retailers to exit the market. We have remained focused on monitoring our customer relationships and working with our customers during these uncertain times. However, even with this uncertainty, we have been able to maintain a leading market share among the top 25 U.S. bedding retailers by wholesale dollars. We believe this is due, in part, to the strength of our customer relationships, our large and well trained sales force, effective marketing, leading brand names and a broad portfolio of quality product offerings.

We believe our sales force is the largest and best trained in the U.S. bedding industry, as evidenced by our high market share among our major retail accounts, new account growth and strong customer retention rates. Our sales strategy supports strong retail relationships through the use of cooperative advertising programs, in-store product displays, sales associate training and a national advertising campaign to support our multiple brand platforms. A key component of our sales strategy is the leveraging of our portfolio of multiple leading brands across the full range of retail price points to capture and retain profitable long term customer relationships.

In Europe, we sell finished mattresses to approximately 4,000 customers including furniture stores, specialty bedding stores and department stores. Additionally, Europe sells latex components to original equipment manufacturers (OEMs) in a variety of industries, though the primary focus is bedding or furniture applications. One customer comprises approximately 30.2% of total sales within Europe in fiscal 2008.

Sales and Marketing

Our sales depend primarily on our ability to provide quality products with recognized brand names at competitive prices. Additionally, we work to build brand loyalty with our end-use consumers, principally through targeted in-country national advertising and cooperative advertising with our dealers, along with superior "point-of-sale" materials designed to emphasize the various features and benefits of our products that differentiate them from other brands.

In 2008, we launched our first national advertising campaign in over a decade, "Get a Better Six", which was designed not only to deliver a strong direct-to-consumer message but also to serve as a platform for our retailers to better leverage their cooperative advertising dollars. The objective of this campaign is to motivate consumers to ask for *Sealy Posturepedic* products by name by achieving over one billion impressions through an integrated marketing campaign including television, print and the Internet.

In January 2008, we realigned our sales force by creating a new position of Executive Vice President of Sales. This position has the responsibility for overseeing all aspects of our U.S. sales force, including field sales, national accounts, regional accounts, and sales training. This change was made to align our sales force with our overall strategic vision and to enable us to operate in a more coordinated and effective fashion.

In the U.S., our national account and regional account sales forces are organized along customer lines, and our field sales force is generally structured based on regions of the country and districts within those regions. We have a comprehensive training and development program for our sales force, including our *University of Sleep* curriculum, which provides ongoing training sessions with programs focusing on advertising, merchandising and sales education, including techniques to help optimize a dealer's business and profitability.

Our sales force emphasizes follow-up service to retail stores and provides retailers with promotional and merchandising assistance, as well as extensive specialized professional training and instructional materials. Training for retail sales personnel focuses on several programs designed to assist retailers in maximizing the effectiveness of their own sales personnel, store operations, and advertising and promotional programs, thereby creating loyalty to, and enhanced sales of, our products.

Operations

We manufacture and distribute products to our customers primarily on a just-in-time basis from our network of 30 company-operated bedding and component manufacturing facilities located around the world. We manufacture most bedding to order and employ just-in-time inventory techniques in our manufacturing process to more efficiently serve our dealers' needs and to minimize their inventory carrying costs. Most bedding orders are scheduled, produced and shipped within five business days of receipt from our plants located in close proximity to a majority of our customers. We believe there are a number of important advantages to this operating model such as the ability to provide superior service and custom products to regional, national and global accounts, a significant reduction in our required inventory investment and short delivery times. We believe these operating capabilities, and the ability to serve our customers, provide us with a competitive advantage.

We believe we are the most vertically integrated U.S. manufacturer of innerspring, box spring and latex components. We distinguish ourselves from our major competitors by maintaining our own component parts manufacturing capability for producing substantially all of our mattress innerspring, box spring and latex component parts requirements. This vertical integration lessens our reliance upon certain key suppliers to the innerspring bedding manufacturing industry and provides us with the following competitive advantages:

- procurement advantage by lessening our reliance upon industry suppliers and thus increasing our flexibility in production;
- production cost advantage via cost savings directly related to our vertically integrated components production capabilities; and
- response time advantage by improving our ability to react to shifts in market demands, thus improving time to market.

Our Europe segment is a leading manufacturer of latex bedding products in Europe, with manufacturing operations in France and Italy. The Europe segment has a proprietary, low cost, high

quality continuous latex production capability. This same process was placed into service at our domestic production facility in Pennsylvania in the second quarter of fiscal 2007 and expanded in the second quarter of fiscal 2008 to supply domestic production requirements. We believe that these processes position us well so that we can offer differentiated products at lower cost.

Suppliers

In the U.S., we rely upon a single supplier for certain polyurethane foam components in our mattress units. Such components are purchased under a measured supply agreement. We continue to develop alternative supply sources, allowing acquisition of similar component parts that meet the functional requirements of various product lines. We also purchase a portion of our box spring parts from third party sources and manufacture the remainder of these parts. We are also dependent on a single supplier for the visco-elastic components and assembly of our *TrueForm* product line. Except for our dependence regarding polyurethane foam, visco-elastic components and assembly of our *TrueForm* product line, we do not consider ourselves to be dependent upon any single outside vendor as a source of supply to our bedding business, and we believe that sufficient alternative sources of supply for the same, similar or alternative components are available.

International

We derived approximately 29.5% of our fiscal 2008 net sales internationally, primarily from Canada and Europe. We also generate income from royalties by licensing our brands, technology and trademarks to other manufacturers, including twelve international independent licensees.

We have 100% owned subsidiaries in Canada, Mexico, Puerto Rico, Argentina, Uruguay, Brazil, France and Italy, which have marketing and manufacturing responsibilities for those markets. We have three manufacturing and distribution center facilities in Canada and one each in Mexico, Puerto Rico, Argentina, Uruguay, Brazil, France and Italy, which comprise all of the company-owned manufacturing operations outside of the U.S. at November 30, 2008. In fiscal 2008, we made the decision to cut back our manufacturing operations in Brazil and move to a business model under which significantly more product will be supplied by production from other Sealy manufacturing facilities. In 2000, we formed a joint venture with our Australian licensee to import, manufacture, distribute and sell *Sealy* products in Southeast Asia. On December 1, 2008, a fifty percent interest in our operations in South Korea was sold for \$1.4 million to our Australian licensee and these operations became part of the joint venture. The South Korean operation principally consists of a sales office that uses a contract manufacturer to service the South Korean market. On December 4, 2008, we acquired a 50% interest in a joint venture with our Australian licensee which owns the assets of our New Zealand licensee for \$1.9 million. In addition to the above, we also ship products directly into many small international markets.

Our international operations are subject to the risks of operating in an international environment, including the potential imposition of trade or foreign exchange restrictions, tariff and other tax increases, fluctuations in exchange rates, inflation and unstable political situations, see "Risk Factors" in Item 1A.

For information regarding revenues and long lived assets by geographic area, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations" in Item 7 as well as Note 19 to our Consolidated Financial Statements in Item 8.

Bedding Industry

General

Our U.S. business within our Americas segment represents the dominant portion of our operations. The U.S. bedding industry generated wholesale revenues of approximately \$6.9 billion during the calendar year 2007, according to the International Sleep Products Association. Based on a sample of leading mattress manufacturers, including Sealy, the International Sleep Products Association

estimates that wholesale revenues for these manufacturers increased approximately 1.4% in 2007. The U.S. bedding industry has historically displayed healthy revenue growth, driven by both growing unit demand and rising average unit selling prices. However, based on information published by the International Sleep Products Association, during the first eleven months of calendar 2008, the sample of leading mattress manufacturers has seen a significant slowdown in volume, which has caused wholesale revenues to decrease approximately 11.5% from the revenues experienced in the first eleven months of 2007.

Our strategy to weather the current economic environment is based on our breadth of product offerings at various price points. Once the global economy begins to recover, we plan to take advantage of an area which we believe has significant opportunity for growth: mattress sales at the premium end of the market (that is, greater than \$1,000 per set) and sales of queen and king size mattresses. According to the International Sleep Products Association, mattress units sold in the United States by manufacturers at retail price points of at least \$1,000, as a percentage of total industry mattress units sold, rose from 14.5% in 2001 to 26.3% in 2007. For 2007, this data was based on data representing 38.6% of total industry units shipped. Additionally, queen and king size mattress units sold in the United States, as a percentage of total mattress units sold, rose from 43.3% in 2000 to 49.4% in 2007, according to the International Sleep Products Association. In addition to the recent slowdown of the global economy, which has caused wholesale domestic innerspring sales levels to decrease 7.2% from 2007 levels through the first nine months of 2008 based on information provided by the International Sleep Products Association, we have seen a shift to products at lower price points. This shift, a sharp increase in raw material costs and the overall retail slowdown has caused lower profitability levels than in previous years.

The specialty bedding category, which represents non-innerspring bedding products including visco-elastic ("memory foam"), latex foam and other mattress products, accounted for approximately 18.9% of the overall U.S. mattress market revenue in 2007 according to the International Sleep Products Association. Though growth in this sector had been seen through 2007, through the first nine months of 2008, wholesale revenue from the specialty bedding category has decreased 15.8% from the levels experienced in the first nine months of 2007. We believe that once the retail environment begins to strengthen, consumers will return to purchases of specialty product and we are positioning ourselves to take advantage of this through continued new product introductions.

Competition

The bedding industry is highly competitive and we encounter competition from many manufacturers in both domestic and foreign markets. Manufacturers in the industry principally compete by developing new products and distributing these new products in retail outlets. While many bedding manufacturers, including Sealy, offer multiple types of bedding products, some of our competitors focus on single product types. The single product focus of these competitors may afford them with a competitive advantage, particularly in the specialty bedding market, but we believe going to market with the best selling and most recognized brand in the domestic bedding industry (*Sealy*) and differentiated specialty bedding offerings provides us a competitive advantage. We, together with Simmons Company and Serta, Inc., collectively accounted for approximately 49.5% of wholesale revenues in 2007, based on figures obtained from International Sleep Products Association and *Furniture/Today* industry publications.

Our Strategy

We intend to deliver profitable sales growth from three sources: U.S. innerspring products, U.S. specialty products and our International markets. We also intend to leverage our scale and vertical integration to reduce costs and maintain our leading position with bedding retailers.

Growth of average unit selling price

We continue to focus on the growth of our average unit selling price (AUSP) through:

- product mix shift with new product introductions;
- slot conversions to higher price points; and
- selective pricing increases.

During fiscal 2008, we introduced a new *Sealy Posturepedic* innerspring line and our new *Sealy Posturepedic PurEmbrace* line of latex specialty products. These new products have helped us to improve our sales mix which has begun translating into AUSP growth. We gained some benefit in fiscal 2008 from the accelerated rollout of these products which was significantly faster than launches in prior years and are hopeful that the AUSP growth of these product lines seen in the third and fourth quarters of 2008 will continue as we expand the distribution of these products in fiscal 2009. Additionally, we implemented price increases in December 2007 and July 2008 which have also contributed to AUSP growth, particularly in the latter half of fiscal 2008. The AUSP growth seen in the third and fourth quarters of 2008 has been partially offset by a shift in mix to lower priced product during fiscal 2008 due to the global economic slowdown.

Implement new advertising and marketing strategies for our retail and direct-to-consumer advertising

In order to better connect directly with consumers and continue to deliver a strong and compelling brand message, we implemented new advertising and marketing strategies for our *Sealy Posturepedic* brand during fiscal 2008. First, we developed and distributed new simplified point-of-sale and advertising materials for this line based on the "No-Toss-And-Turn" positioning. Afterwards, we launched our first national advertising campaign in over a decade, "Get a Better Six", which was designed not only to deliver a strong direct-to-consumer message but also to serve as a platform for our retailers to better leverage their cooperative advertising dollars. The objective of this campaign is to motivate consumers to ask for *Sealy Posturepedic* products by name by achieving over one billion impressions through television, print and the Internet.

Increase our profit margins

We intend to increase our profit margins over time. We seek to accomplish this by increasing AUSP as discussed above and in the following principal ways:

- Utilizing our value-engineering expertise to reduce our exposure to the highest cost materials and identifying and removing non-value added production costs while still enhancing product quality and feel to optimize flow and first pass yields;
- Implementing more efficient manufacturing techniques as well as other discrete cost reduction initiatives;
- Using management metrics to benchmark our manufacturing performance on key measures and drive comparative best practices across our manufacturing base;
- Driving efficiency in our supply chain including strategic sourcing initiatives;
- Increasing the focus on higher margin, premium and specialty bedding categories and providing compelling reasons to our customers and consumers to invest in these products; and
- Managing our fixed cost base consistent with the retail market environment.

In 2008, we experienced unprecedented increases in the cost of our steel innerspring, polyurethane foam, polyester and polyethylene component parts, due to the rising cost of steel and petroleum. In order to counter these rising costs and drive increases in our profit margins, we have implemented pricing increases and measures to remove non-value added costs out of the domestic production process. We have also begun the process of implementing similar measures at our international locations. Due to the completion of our second domestic latex production line at our Mountain Top,

Pennsylvania facility, we have been able to achieve more vertical integration for our *SmartLatex* product.

Reduce fixed expenses

Over the course of the past two years, we have implemented actions designed to reduce our fixed operating expenses, selling, logistics and infrastructure, as well as product launch costs. These actions have focused primarily on controlling costs, organizational realignments and more efficient product launches in the U.S. Through these actions, we have streamlined our workforce in the U.S. and have worked to reduce costs in areas such as travel and entertainment and professional fees without sacrificing our execution or performance. Additionally, we have been able to significantly reduce our product launch costs during 2008 by accelerating the process through which these launches are made, enabling us to not only reduce our costs but also bring innovative new products to market more rapidly.

While many of these actions have focused on the domestic operations, we plan to also implement these same types of initiatives in our international locations, particularly Canada and Europe in future periods.

Commitment to specialty products

The specialty bedding category includes visco-elastic "memory foam" and latex foam and has experienced substantial growth both domestically and internationally. We believe that by successfully leveraging our strong brand advantage, proprietary latex manufacturing technology, and marketing and distribution capabilities, we have the potential to continue to make significant market share gains in the specialty bedding category, which according to consumer and market research, will continue to be a significant category of the market.

Since our introduction of specialty bedding products in 2005 to take advantage of the growth in the specialty bedding category, we have continued innovative product introductions including significant changes to our *Sealy Posturepedic TrueForm* product designs and supply chain during fiscal 2007 and the introduction of the *Sealy Posturepedic PurEmbrace* mattress featuring the Company's proprietary *SmartLatex* in June 2008. Additionally in 2006, we began the construction of a proprietary, continuous latex production facility in Mountain Top, Pennsylvania utilizing the technology employed in our European manufacturing facilities. This facility now has two operational production lines, which have allowed us to discontinue importing latex product from our European facilities and to gain vertical integration in the specialty category in the U.S. With the completion of this facility in fiscal 2007 and the second production line in fiscal 2008, we have now shifted our focus towards optimizing the efficiency of the production process and developing innovative new formulations for use in our specialty product.

Drive disproportionate growth in our international markets

We plan to grow our international business through market-oriented strategies. In Canada, where we have the leading market share position, we also intend to expand our presence by executing a strategy which is similar to that utilized in the U.S. market. In Europe, we seek to gain market share from regional competition in a fragmented market by building on our foundation of OEM business and leveraging our sales, marketing and proprietary manufacturing expertise. In Mexico, where we recently launched specialty products for the first time, we have continued to see sales growth in fiscal 2008. In Argentina and Uruguay, we plan to profitably grow our positions by leveraging our sales, marketing and product development capabilities. In Brazil, we have implemented a plan to cut back our manufacturing operations and move to a business model under which significantly more product will be supplied by production from other Sealy manufacturing facilities. In addition, we anticipate further growth from international licensees.

We believe ongoing product innovation is central to increasing market share and driving revenue growth in our industry. With respect to Sealy's ability to introduce new products, we employ a cross-functional product development process and make substantial investments in consumer research and analysis. The combination of this research-based approach to satisfying customer needs and the collaborative input of our sales, marketing, research and development, engineering, purchasing, finance and manufacturing departments into the product design process will maximize our potential for successful new product introductions over time.

In January 2008, we unveiled an innovative new *Sealy Posturepedic* innerspring line, which is designed to eliminate tossing and turning caused by pressure points. The line was designed in conjunction with orthopedic surgeons, and reviewed by an independent Orthopedic Advisory Board. These mattresses come in three series: Preferred, Reserve and Signature, and range in retail price points from \$599 to more than \$1,000 in queen set.

In addition to developing new product, we have made significant investments in people and tools to increase our capacity for conducting research on new materials and designs. In 2005, we built our own flammability testing facility, which allows us to experiment with materials and designs that ensure that our new products meet the federal flame retardant standard 16 CFR Part 1633 passed by the U.S. Consumer Product Safety Commission and allows us to accelerate the product development cycle.

In 2008, we unveiled our new Center of Excellence pressure mapping laboratory. The Center is an innovative, state of the art research laboratory that uses the latest technologies to identify uncomfortable pressure points that lead to tossing and turning. This will allow us to better quantify sleep quality and directly link it to sleep surfaces. We will then be able to use this proprietary research to further enhance our products and develop new technologically advanced beds.

Other Company Information

Licensing

At November 30, 2008, there were 20 separate license arrangements in effect with 8 domestic and 12 foreign independent licensees. Sealy New Jersey (a bedding manufacturer), Klaussner Corporation Services (a furniture manufacturer), Kolcraft Enterprises, Inc. (a crib mattress manufacturer), Pacific Coast Feather Company (a pillow, comforter and mattress pad manufacturer), Chairworks Manufacturing Group Limited (an office seating manufacturer), Mantua Manufacturing Co. (a bed frame manufacturer) and KCB Enterprises (a futon manufacturer) and SG Footwear (a slipper manufacturer) are the only domestic manufacturers that are licensed to use the *Sealy* trademark, subject to the terms of license agreements. Pacific Coast Feather also has a license to use the *Stearns & Foster* brand on certain approved products. Under license agreements between Sealy New Jersey and us, Sealy New Jersey has the perpetual right to use certain of our trademarks in the manufacture and sale of *Sealy* brand and *Stearns & Foster* brand products in selected markets in the United States.

Our 12 foreign license agreements provide exclusive rights to market the *Sealy* brand in Thailand, Japan, the United Kingdom, Spain, Australia, New Zealand, South Africa, Israel, Saudi Arabia, Jamaica, Bahamas and the Dominican Republic. These licensing agreements allow us to reduce our exposure to political and economic risk abroad by minimizing investments in those markets. On December 4, 2008, we acquired a 50% interest in a joint venture with our Australian licensee which owns the assets of our New Zealand licensee for \$1.9 million.

Our licensing group generates royalties by licensing *Sealy* brand technology and trademarks to manufacturers located throughout the world. We also provide our licensees with product specifications, research and development, statistical services and marketing programs. In the fiscal years ended November 30, 2008, December 2, 2007, and November 26, 2006, the licensing group as a whole

generated unaffiliated gross royalties of approximately \$17.6 million, \$19.2 million, and \$19.2 million, respectively.

Intellectual Property

We have approximately 200 worldwide patents, of which the patents and pending patent applications relating to our *UniCased* technology, those patents that protect our proprietary spring and coil designs and our latex production process, are believed by us to be our most valuable. These patents, having been just recently issued or still pending, afford us multiple years of continuing protection of certain mattress designs. We have filed for patent protection for the core *UniCased* technology in 30 countries to date and expect similar competitive benefits from the issuance of those patents in those countries. The patents covering our proprietary spring and coil designs also provide Sealy with a competitive advantage in the U.S. and in other countries where we have a presence, and these patents have a remaining enforceable period of at least 13 years.

We own thousands of trademarks, tradenames, service marks, logos and design marks, including *Sealy*, *Stearns & Foster* and *Posturepedic*. We also license the *Bassett* and *Pirelli* tradenames in various territories under certain long term agreements. With the exception of the Sealy New Jersey license, the domestic licenses are predominantly trademark licenses. Also, with the exception of the Sealy New Jersey license (which is of perpetual duration), each domestic license is limited by a period of years, all of which are for a length of five years or less.

Of our over 675 worldwide trademarks, we believe that our *Sealy*, *Posturepedic*, and *Stearns & Foster* marks and affiliated logos (the Sealy script, the "butterfly logo" and the *Stearns & Foster* "seal") are the most well known. We have registered the *Sealy* and *Posturepedic* marks in over 35 countries.

Our licenses include rights for the licensees to use trademarks as well as current proprietary or patented technology utilized by us. We also provide our licensees with product specifications, quality control inspections, research and development, statistical services and marketing programs. Only the New Jersey, Australia, United Kingdom and Jamaica licenses are of perpetual duration (with some rights of termination), while the other licenses are for a set duration or are indeterminate in length and subject to reasonable notice provisions. All licenses have provisions for termination for cause (such as bankruptcy, misuse of the mark or violation of standards), approval of marketing materials, audit rights and confidentiality of proprietary data.

Warranties and Product Returns

Sealy, *Stearns & Foster* and *Bassett* bedding offer limited warranties on our manufactured products. The periods for "no-charge" warranty service vary among products. Prior to fiscal year 1995, such warranties ranged from one year on promotional bedding to 20 years on certain *Posturepedic* and *Stearns & Foster* bedding. All currently manufactured *Sealy Posturepedic* models, *Stearns & Foster* bedding, *Bassett* and some other *Sealy* branded products offer a ten year non-prorated warranty service period. Our *TrueForm* visco-elastic line of bedding as well as our *SpringFree* latex line of bedding, carry a twenty year warranty on the major component, the last ten years of which are prorated on a straight-line basis. In 2006, we introduced *Right Touch* (which was discontinued in the third quarter of fiscal 2008), that had a twenty year limited warranty that covers only certain parts of the product and is prorated for part of the twenty years. In fiscal 2000, we amended our warranty policy to no longer require the mattress to be periodically flipped. In fiscal 2007, we amended our warranty policy on *Sealy* brand promotional bedding to three years for our new line introduced in January 2007 and shipped in the second quarter of fiscal 2007. The impact of the changes to the warranty policies did not have a significant impact on our financial results or position.

Employees

As of November 30, 2008 we had 4,817 full time employees. Approximately 58% of our employees at our 25 North American plants are represented by various labor unions with separate collective bargaining agreements. Due to the large number of collective bargaining agreements, we are periodically in negotiations with certain of the unions representing our employees. We consider our overall relations with our work force to be satisfactory. We have only experienced two work stoppages by some of our employees in the last ten years due to labor disputes. Due to the ability to shift production from one plant to another, these lost workdays have not had a material adverse effect on our financial results. The only significant organizing activity at our non-union plants during the last ten years was a petition filed by the Teamsters seeking to organize the production employees at our Mountain Top, Pennsylvania facility. At the subsequent election, the union was defeated by a wide margin. Our current collective bargaining agreements, which are typically three years in length, expire at various times beginning in 2009 through 2011. As of November 30, 2008, our domestic manufacturing plants employed 534, 1,003 and 283 employees covered under collective bargaining agreements expiring in fiscal 2009, 2010, and 2011, respectively. At our international facilities, there were 706, 817 and 698 employees covered under collective bargaining agreements expiring in fiscal 2009, 2010 and 2011, respectively.

Seasonality and Production Cycle

Our third fiscal quarter sales are typically 5% to 15% higher than other fiscal quarters. See Note 17 to our Consolidated Financial Statements in Item 8.

Most of our sales are by short term purchase orders. Since the level of production of products is generally promptly adjusted to meet customer order demand, we have a negligible backlog of orders. Most finished goods inventories of bedding products are physically stored at manufacturing locations until shipped (usually within five business days of accepting the order). See "Risk Factors—We may experience fluctuations in our operating results due to seasonality, which could make sequential quarter to quarter comparison an unreliable indication of our performance." in Item 1A below.

Regulatory Matters

Our conventional bedding product lines are subject to various federal and state laws and regulations relating to flammability and other standards. We believe that we are in compliance with all such laws and regulations, including the California flame retardant regulations related to manufactured mattresses and box springs, which became effective January 1, 2005. In addition, we introduced new *Sealy*-branded products that are compliant with the Federal flame retardant standards, 16 CFR Part 1633 passed by the U.S. Consumer Product Safety Commission, which became effective July 1, 2007. The impact of these regulations increased our costs to develop and manufacture our products.

Our principal waste products in North America are foam and fabric scraps, wood, cardboard and other non-hazardous materials derived from product component supplies and packaging. We also periodically dispose of (primarily by recycling) small amounts of used machine lubricating oil and air compressor waste oil. In the United States, we are subject to federal, state and local laws and regulations relating to environmental health and safety, including the Federal Water Pollution Control Act and the Comprehensive Environmental Response, Compensation and Liability Act. In our facilities in Mountain Top, Pennsylvania, Argentina, France and Italy, we also manufacture foam. We believe that we are in compliance with all applicable international, federal, state and local environmental statutes and regulations. Except as set forth in "Item 3—Legal Proceedings" below, compliance with international, federal, state or local provisions that have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, should not have any material effect upon our capital expenditures, earnings or competitive position. We are not aware of any pending federal environmental legislation which would have a material impact on our operations. Except as set forth in "Item 3—Legal Proceedings" below, we have not been required to make and do not expect to make any material capital expenditures for environmental control facilities in the foreseeable future.

Item 1A. Risk Factors

The bedding industry is highly competitive, and if we are unable to compete effectively, we may lose customers and our sales may decline.

The bedding industry is highly competitive, and we encounter competition from many manufacturers in both domestic and foreign markets. We, along with Simmons Company and Serta, Inc., accounted for approximately 49.5% of wholesale revenues in 2007, according to figures obtained from International Sleep Products Association and *Furniture/Today* industry publications. The highly competitive nature of the bedding industry means we are continually subject to the risk of loss of our market share, loss of significant customers, reduction in margins, the inability for us to gain market share or acquire new customers, and difficulty in raising our prices. Some of our principal competitors have less debt than we have and may be better able to withstand changes in market conditions within the bedding industry. Additionally, we may encounter increased future competition and further consolidation in our industry which could magnify the competitive risks previously outlined.

Our new product launches may not be successful due to development delays, failure of new products to achieve anticipated levels of market acceptance and significant costs associated with failed product introductions, which could adversely affect our revenues and profitability.

Each year we invest significant time and resources in research and development to improve our product offerings. There are a number of risks inherent in our new product line introductions, such as the anticipated level of market acceptance may not be realized, which could negatively impact our sales. Also, introduction costs and manufacturing inefficiencies may be greater than anticipated, which could impact our profitability.

We may experience fluctuations in our operating results due to seasonality, which could make sequential quarter to quarter comparison an unreliable indication of our performance.

We have historically experienced, and we expect to continue to experience, seasonal and quarterly fluctuations in net sales and operating income. As is the case with many bedding customers, the retail business is subject to seasonal influences, characterized by strong sales for the months of June through September, which impacts our third fiscal quarter results. Our third fiscal quarter sales are typically 5% to 15% higher than other fiscal quarters. Our first fiscal quarter cash flows are typically the most unfavorable due to coupon payments on our 2014 Notes and working capital demands. This seasonality means that a sequential quarter to quarter comparison may not be a good indication of our performance or of how we will perform in the future.

A substantial decrease in business from our significant customers could have a material adverse effect on our sales and market share.

Our top five customers on a consolidated basis accounted for approximately 25.4% of our net sales for fiscal 2008 and no single customer represented more than 10% of net sales for fiscal 2008. While we believe our relationships with these customers are stable, many arrangements are made by purchase order or are terminable at will at the option of either party. A substantial decrease or interruption in business from our significant customers could result in material write offs or loss of future business. During 2008, the economic environment has become more challenging and has caused a higher occurrence of bankruptcies for mattress retailers. It has also caused many of the smaller mattress retailers to exit the market. This has resulted in additional write-offs and customer losses during fiscal 2008. Furthermore, many of our customers rely in part on consumers' ability to finance their mattress purchases with credit from third parties. If consumers are unable to obtain financing, they may defer their purchases.

In the future, retailers may consolidate, restructure, reorganize or realign their affiliations, any of which could decrease the number of stores that carry our products or increase the ownership concentration in the retail industry. Some of these retailers may decide to carry only one brand of mattress products which could affect our ability to sell our products on favorable terms or to maintain or increase market share. As a result, our sales and profitability may decline.

Our profitability may be materially and adversely affected by increases in the cost of petroleum-based products, steel and other raw materials.

Our industry has been challenged by the unprecedented volatility in the price of petroleum-based and steel products, which affects the cost of our polyurethane foam, polyester, polyethylene foam and steel innerspring component parts. Domestic supplies of these raw materials are being limited by supplier consolidation, the exporting of these raw materials outside of the U.S. due to the weakened dollar and other forces beyond our control. During fiscal 2007 and 2008, the cost of these components saw significant increases above their recent historical averages. The manufacturers of products such as petro-chemicals and wire rod, which are the materials purchased by our suppliers of foam and drawn wire, may reduce supplies in an effort to maintain higher prices. These actions would delay or eliminate price reductions from our suppliers.

Our profitability may be materially and adversely affected by any interruption in supply from third party vendors.

We purchase our raw materials and certain components from a variety of suppliers, including box spring components from Leggett & Platt Inc., foam materials from Carpenter Co., and various subassemblies and components from national raw material and component suppliers. If we experience a loss or disruption in our supply of these components, we may have difficulty sourcing substitute components on terms favorable to us. In addition, any alternate source may impair product performance or require us to alter our manufacturing process, which could have an adverse effect on our profitability.

We are dependent upon a single supplier for certain polyurethane foam components in our mattress units. A disruption in the supply of these products and services could adversely affect our operations.

We are dependent upon a single supplier for certain key polyurethane foam components which make up our various mattress brands. Such components are purchased under a measured supply agreement and are manufactured in accordance with proprietary process designs exclusive to the supplier. If we experience a loss or disruption in our supply of these components, we may have difficulty sourcing substitute components on terms favorable to us. In addition, any alternative source may impair product performance or require us to alter our manufacturing process, which could have an adverse effect on our profitability.

We are dependent upon a single supplier for the visco-elastic components and assembly of our TrueForm product line. A disruption in the supply of these products and services could adversely affect our operations.

We are dependent upon a single supplier for certain structural components and assembly of our *TrueForm* product line. These products are purchased under a measured supply agreement and are manufactured in accordance with proprietary designs jointly owned by us and the supplier. If we experience a loss or disruption in our supply of these products, we may have difficulty sourcing substitute components on terms favorable to us. In addition, any alternative source may impair product performance or require us to alter our manufacturing process, which could have an adverse effect on our profitability. The related product in which these components and assembly processes are used does not represent a significant portion of our overall sales.

Our significant international operations are subject to foreign exchange, tariff, tax, inflation and political risks and our ability to expand in certain international markets is limited by the terms of licenses we have granted to manufacture and sell Sealy products.

We currently conduct significant international operations and may pursue additional international opportunities. Our international operations are subject to the risks of operating in an international environment, including the potential imposition of trade or foreign exchange restrictions, tariff and other tax increases, fluctuations in exchange rates, inflation and unstable political situations. We have also limited our ability to independently expand in certain international markets where we have granted licenses to manufacture and sell *Sealy* bedding products. Our licensees in Australia, Jamaica and the United Kingdom have perpetual licenses, subject to limited termination rights. Our licensees in the Dominican Republic, the Bahamas, Israel, Japan, New Zealand, Saudi Arabia, Spain, South Africa and Thailand hold licenses for fixed terms with limited renewal rights. Fluctuations in the rate of exchange between the U.S. dollar and other currencies may affect stockholders' equity and our financial condition or results of operations.

The loss of the services of one or more members of our senior management team could impair our ability to execute our business strategy and adversely affect our business.

We are dependent on the continued services of our senior management team, most of whom have substantial industry specific experience. For example, Lawrence J. Rogers, our current President and Chief Executive Officer (former President, Sealy North America from December 2006 through March 2008), has served in numerous capacities within our operations since joining us in 1979. The loss of key personnel could impair our ability to execute our business strategy and have a material adverse effect on our business.

We have a substantial amount of indebtedness, which may adversely affect our cash flow, our ability to comply with our debt covenants and operate our business.

At November 30, 2008, we had outstanding indebtedness, of approximately \$783.4 million, with additional availability of \$44.7 million under the revolving credit facility after taking into account letters of credit for \$15.9 million.

We paid \$58.2 million of interest during fiscal 2008. In November 2008, we amended our senior credit facility, which increased the applicable interest rate margins by 275 to 325 basis points. Due to the significant amount of debt outstanding under this agreement, this amendment will have a significant impact on our required interest payments to be made in future periods. Subsequent to year-end, we entered into two interest rate swap agreements which converted an additional \$107.0 million of our floating rate debt to a fixed rate through February 4, 2010 and an additional \$20.0 million of our floating rate debt to a fixed rate through November 4, 2009. After considering these hedges and giving effect to the amended interest rates, a 1% increase in the interest rates applicable to the unhedged portion of our variable rate debt would result in approximately \$0.8 million in additional annual cash interest expense. We have scheduled quarterly principal payments due on Tranche A of our senior secured term loan of 1.25% of the then outstanding principal from November 2008 through August 2010 and quarterly principal payments of 21.25% of the then outstanding principal amount from November 2010 through the maturity date in August 2011. As of November 30, 2008, we have prepaid these quarterly principal payments on Tranche A through the end of the third quarter of fiscal 2009. On Tranche E of our senior secured term loan, we have no scheduled quarterly principal prepayments due until the maturity date in August 2012 due to prepayments made in fiscal 2007. There are no scheduled principal prepayments due on our senior subordinated debt until the maturity date in June 2014. In addition, each year our senior secured term notes remain outstanding, we may be required to make principal prepayments depending on certain financial ratios, as defined in our senior secured

credit agreement. We do not expect there to be any mandatory prepayments due in fiscal 2009. We are unable to estimate whether any such prepayments may continue to be required after 2009.

Our substantial indebtedness could have important consequences. For example, it could:

- limit our ability to pay dividends on our common stock;
- make it more difficult for us to satisfy our obligations with respect to our outstanding debt, and a failure to comply with any financial and other restrictive covenants could result in an event of default under our debt instruments and agreements;
- require us to dedicate a substantial portion of our cash flow to pay principal and interest on our debt, which will reduce the funds available for dividends on our common stock, working capital, capital expenditures, acquisitions and other general corporate purposes;
- limit our flexibility in planning for and reacting to changes in our business and in the industry in which we operate;
- make us more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in government regulation;
- limit our options to effect a sale of assets through non-cash or sale/leaseback transactions;
- limit our ability to borrow additional amounts for working capital, capital expenditures, acquisitions, debt service requirements, execution of our strategy, or other purposes; and
- place us at a disadvantage compared to our competitors who have less debt.

Any of the above listed factors could materially and adversely affect our business, financial condition or results of operations.

Despite our current leverage, we may still be able to incur significant additional indebtedness. This could further exacerbate the risks that we face.

We may be able to incur significant additional indebtedness in the future. Although the indenture governing our 8.25% senior subordinated notes due June 2014 (the "2014 Notes") and the instruments governing our senior secured indebtedness contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of important qualifications and exceptions and the indebtedness incurred in compliance with these restrictions could be substantial. If new debt is added to our existing debt levels, the related risks that we now face, including those described above, could intensify.

The terms of the senior secured credit facilities and the indenture governing the 2014 Notes may restrict our current and future operations, particularly our ability to respond to changes in our business or to take certain actions.

Our senior secured credit facilities and the indenture governing the 2014 Notes contain, and any future indebtedness of ours would likely contain, a number of restrictive covenants that impose significant operating and financial restrictions on our subsidiaries, including restrictions that may limit our ability to engage in acts that may be in our best long term interests. The senior secured credit facilities include financial covenants, including requirements that we:

- maintain a minimum interest coverage ratio; and
- not exceed a maximum total leverage ratio.

The financial covenants contained in the senior secured credit facilities were amended in fiscal 2008 to make them less restrictive, but they will become more restrictive over time. In addition, the

senior secured credit facilities limit our subsidiaries' ability to make capital expenditures and require that they use proceeds of certain asset sales that are not reinvested in our business to repay indebtedness under them.

The senior secured credit facilities also include covenants restricting, among other things, our subsidiaries' ability to:

- incur or guarantee additional debt or issue preferred stock;
- pay dividends, or make redemptions and repurchases, with respect to capital stock;
- create or incur certain liens;
- make prepayments on subordinated debt;
- make certain loans, acquisitions, capital expenditures or investments; and
- engage in mergers, acquisitions, asset sales and sale and lease-back transactions.

The indenture relating to the 2014 Notes also contains numerous covenants including, among other things, restrictions on our subsidiaries' ability to:

- incur or guarantee additional indebtedness or issue disqualified or preferred stock;
- create liens;
- enter into sale and lease-back transactions;
- pay dividends or make other equity distributions;
- repurchase or redeem capital stock;
- make investments or other restricted payments;
- sell assets or consolidate or merge with or into other companies;
- create limitations on the ability of Sealy Mattress Company and its restricted subsidiaries to make dividends or distributions to Sealy Mattress Corporation (a 100%-owned subsidiary of Sealy Corporation); and
- engage in transactions with affiliates.

The operating and financial restrictions and covenants in our existing debt agreements and any future financing agreements may adversely affect our ability to finance future operations or capital needs or to engage in other business activities. A breach of any of the restrictive covenants in our debt agreements could result in a default under such agreements. If any such default occurs, the lenders under the debt agreements may elect to declare all outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable, enforce their security interest or require us to apply all of our available cash to repay these borrowings, any of which would result in an event of default under our notes. Those lenders will also have the right in these circumstances to terminate any commitments they have to provide further borrowings. If we are unable to repay outstanding borrowings when due, the lenders under the senior secured credit facilities will have the right to proceed against the collateral granted to them to secure the debt owed to them. If the debt payments under the senior secured credit facilities were to be accelerated, our assets may not be sufficient to repay such debt in full or to repay our notes and our other debt.

Unfavorable economic conditions could continue to negatively affect our revenues and profitability.

Our business, financial condition and results of operations have and may continue to be affected by various economic factors. The global economy is undergoing a period of slowdown, which is

characterized as a recession, and the future economic environment may continue to be less favorable than that of recent years. The U.S. economy, which contains our largest market, has been in a recession throughout much of fiscal 2008. This slowdown has, and could further lead to, reduced consumer and business spending in the foreseeable future, including by our customers, and the purchasers of their products. Reduced access to credit has and may continue to adversely affect the ability of consumers to purchase our products from retailers. It has and may continue to adversely affect the ability of our customers to pay us. If such conditions continue or further deteriorate in 2009 or through fiscal 2010, our industry, business and results of operations may be severely impacted

The time and expense of defending against challenges to our trademarks, patents and other intellectual property could divert our management's attention and substantial financial resources from our business. Our goodwill and ability to differentiate our products in the marketplace could be negatively affected if we were unsuccessful in defending against such challenges.

We hold over 675 worldwide trademarks, which we believe have significant value and are important to the marketing of our products to customers. We own 42 U.S. patents, a number of which have been registered in a total of 31 countries, and we have 6 domestic patents pending. In addition, we own U.S. and foreign registered trade names and service marks and have applications for the registration of trade names and service marks pending domestically and abroad. We also own several U.S. copyright registrations, and a wide array of unpatented proprietary technology and know-how. We also license certain intellectual property rights from third parties.

Our ability to compete effectively with other companies depends, to a significant extent, on our ability to maintain the proprietary nature of our owned and licensed intellectual property. Although our trademarks are currently registered in the United States and registered or pending in 96 foreign countries, we still face risks that our trademarks may be circumvented or violate the proprietary rights of others and we may be prevented from using our trademarks if challenged. A challenge to our use of our trademarks could result in a negative ruling regarding our use of our trademarks, their validity or their enforceability, or could prove expensive and time consuming in terms of legal costs and time spent defending against it. In addition, we may not have the financial resources necessary to enforce or defend our trademarks. We also face risks as to the degree of protection offered by the various patents, the likelihood that patents will be issued for pending patent applications or, with regard to the licensed intellectual property, that the licenses will not be terminated. If we were unable to maintain the proprietary nature of our intellectual property and our significant current or proposed products, our goodwill and ability to differentiate our products in the marketplace could be negatively affected and our market share and profitability could be materially and adversely affected.

We are a holding company and rely on dividends, interest and other payments, advances and transfers of funds from our subsidiaries to enable us to pay dividends.

We are a holding company and conduct all of our operations through our subsidiaries and currently have no significant assets other than the capital stock of Sealy Mattress Corporation and the license to use the *Pirelli* brand name in European territories. As a result, we rely on dividends and other payments or distributions from our subsidiaries to enable us to pay dividends. The ability of our subsidiaries to pay dividends or make other payments or distributions to us will depend on their respective operating results and may be restricted by, among other things, the laws of their jurisdiction of organization (which may limit the amount of funds available for the payment of dividends), agreements of those subsidiaries and the covenants of any existing and future outstanding indebtedness we or our subsidiaries incur, including Sealy Mattress Company's senior secured credit facilities and the indenture governing the 2014 Notes. For instance, the agreement governing Sealy Mattress Company's senior secured credit facilities contains restrictions on the ability of Sealy Mattress Corporation to pay dividends or make other distributions to us subject to specified exceptions including an amount based

upon 50% of cumulative consolidated net income from April 2004. We are also required under this agreement to meet a minimum leverage ratio test in order to pay a dividend. We currently do not meet this requirement and therefore are not able to pay a dividend. In addition, the indenture governing the 2014 Notes contains restrictions on the ability of Sealy Mattress Company to pay dividends or make other distributions to Sealy Mattress Corporation subject to specified exceptions including an amount based upon 50% of cumulative consolidated net income from April 2004.

Regulatory requirements relating to our products may increase our costs, alter our manufacturing processes and impair our product performance.

Our products and raw materials are and will continue to be subject to regulation in the United States by various federal, state and local regulatory authorities. In addition, other governments and agencies in other jurisdictions regulate the sale and distribution of our products and raw materials. These rules and regulations may change from time to time. Compliance with these regulations may negatively impact our business. For example, the California Home Furnishings Bureau adopted new open flame resistance standards under Technical Bulletin 603, that became effective in January 2005. There may be continuing costs of regulatory compliance including continuous testing, additional quality control processes and appropriate auditing of design and process compliance.

In February 2005, the U.S. Consumer Product Safety Commission (CPSC) passed 16 CFR Part 1633 that effectively applies the California open flame standard, but added significant quality control, record keeping and testing requirements on mattress manufacturers, including Sealy. This rule became effective on July 1, 2007. Further, some states and the U.S. Congress continue to consider open flame regulations for mattresses and bed sets or integral components that may be different or more stringent than the California or CPSC standard and we may be required to make different products for different states or change our processes or distribution practices nationwide. It is possible that some states' more stringent standards, if adopted and enforceable, could make it difficult to manufacture a cost effective product in those jurisdictions and compliance with proposed new rules and regulations may increase our costs, alter our manufacturing processes and impair the performance of our products.

In addition, our marketing and advertising practices could become the subject of proceedings before regulatory authorities or the subject of claims by other parties, which could require us to alter or end these practices or adopt new practices that are not as effective or are more expensive.

Environmental, health and safety requirements could expose us to material liabilities and changes in our operations as a result of environmental contamination, among other things.

As a manufacturer of bedding and related products, we use and dispose of a number of substances, such as glue, lubricating oil, solvents and other petroleum products, as well as certain foam ingredients that may subject us to regulation under numerous federal and state statutes governing the environment (including those environmental regulations that are applicable to our foreign operations such as Argentina, Brazil, Canada, France, Italy, Mexico, Uruguay and other jurisdictions). Among other statutes, we are subject to the Federal Water Pollution Control Act, the Comprehensive Environmental Response, Compensation and Liability Act, the Resource Conservation and Recovery Act, the Clean Air Act and related state statutes and regulations. As we abide by certain new open flame regulations, our products and processes may be governed more rigorously by certain state and federal environmental and OSHA standards as well as the provisions of California Proposition 65 and 16 CFR Part 1633.

We have made and will continue to make capital and other expenditures to comply with environmental requirements. We also have incurred and will continue to incur costs related to certain remediation activities. Under various environmental laws, we may be held liable for the costs of remediating releases of hazardous substances at any properties currently or previously owned or

operated by us or at any site to which we sent hazardous substances for disposal. We are currently addressing the clean-up of environmental contamination at our former facility in South Brunswick, New Jersey and our former facility in Oakville, Connecticut. At November 30, 2008, we have accrued approximately \$0.2 million and \$2.8 million for the Oakville and South Brunswick clean-ups, respectively, and we believe that these reserves are adequate. While uncertainty exists as to the ultimate resolution of these two environmental matters and we believe that the accruals recorded are adequate, in the event of an adverse decision by one or more of the governing environmental authorities or if additional contamination is discovered, these matters could have a material effect on our profitability.

A change or deterioration in labor relations could disrupt our business or increase costs, which could lead to a material decline in sales or profitability.

As of November 30, 2008, we had 4,817 full time employees. Approximately 58% of our employees at our 25 North American plants are represented by various labor unions with separate collective bargaining agreements. Our current collective bargaining agreements, which are typically three years in length, expire at various times beginning in 2009 through 2011. Due to the large number of collective bargaining agreements, we are periodically in negotiations with certain of the unions representing our employees. We may at some point be subject to work stoppages by some of our employees and, if such events were to occur, there may be a material adverse effect on our operations and profitability. Further, we may not be able to renew the various collective bargaining agreements on a timely basis or on favorable terms, or at all.

Our pension plans are currently underfunded and we will be required to make cash payments to the plans, reducing the cash available for our business.

We have noncontributory, defined benefit pension plans covering current and former hourly employees at four of our active plants and eight previously closed facilities as well as the employees of a facility of our Canadian operations and our manufacturing facility in France. We record a liability associated with these plans equal to the excess of the benefit obligation over the fair value of plan assets. The benefit liability recorded under the provisions of Statement of Financial Accounting Standards No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)" at November 30, 2008 was \$9.2 million, and we expect to make estimated minimum funding contributions totaling approximately \$1.2 million in 2009. The amount of these estimated contributions has increased for our domestic pension plan for next year due, in part, to the underperformance of the plan assets relative to our expectations given the overall market downturn during fiscal 2008. If the performance of the assets in these pension plans does not meet our expectations, or if other actuarial assumptions are modified, our future cash payments to the plans could be higher than we expect. The domestic pension plan is subject to the Employee Retirement Income Security Act of 1974, or ERISA. Under ERISA, the Pension Benefit Guaranty Corporation, or PBGC, has the authority to terminate an underfunded pension plan under limited circumstances. In the event our pension plan is terminated for any reason while it is underfunded, we will incur a liability to the PBGC that may be equal to the entire amount of the underfunding.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. Properties

Our principal executive offices are located on Sealy Drive at One Office Parkway, Trinity, North Carolina, 27370. Corporate and administrative services are provided to us by Sealy, Inc. (our 100%-owned subsidiary).

We administer our component operations at our Rensselaer, Indiana facility. Our leased facilities are occupied under operating leases, which expire from fiscal 2009 to 2043, including renewal options.

The following table sets forth certain information regarding manufacturing and distribution facilities operated by us at January 2, 2009:

Location		Approximate Square Footage	Title
United States			
Arizona	Phoenix	76,000	Owned(a)
California	Richmond	238,000	Owned(a)
	South Gate	185,000	Leased
Colorado	Colorado Springs	70,000	Owned(a)
	Denver	92,900	Owned(a)
Florida	Orlando	225,000	Owned(b)
Georgia	Atlanta	292,500	Owned(a)
Illinois	Batavia	212,700	Leased
Indiana	Rensselaer	131,000	Owned(a)
	Rensselaer	124,000	Owned(a)
Kansas	Kansas City	102,600	Leased
Maryland	Williamsport	144,000	Leased
Minnesota	St. Paul	93,600	Owned(a)
New York	Green Island	257,000	Owned(b)
North Carolina	High Point	151,200	Owned(a)
Ohio	Medina	140,000	Owned(a)
Oregon	Portland	140,000	Owned(a)
Pennsylvania	Delano	143,000	Owned(a)
	Mountain Top	210,000	Owned(b)
Texas	Brenham	220,000	Owned(a)
	North Richland Hills	124,500	Owned(a)
Canada			
Alberta	Edmonton	144,500	Owned(a)
Quebec	Saint Narcisse	76,000	Owned(a)
Ontario	Toronto	130,200	Leased
Argentina	Buenos Aires	85,000	Owned
Brazil	Sorocaba	92,000	Owned
Puerto Rico	Carolina	58,600	Owned(a)
Italy	Silvano d'Orba	170,600	Owned(a)(c)
France	Saleux	239,400	Owned(c)
Mexico	Toluca	157,100	Owned
Uruguay	Montevideo	39,500	Leased
		4,565,900	

(a) We have granted a mortgage or otherwise encumbered our interest in this facility as collateral for secured indebtedness.

(b) We engaged third parties to construct these facilities to be leased by us. Emerging Issues Task Force Issue No. 97-10, "The Effect of Lessee Involvement in Asset Construction" ("EITF 97-10"), is applied to entities involved with certain structural elements of the construction of an asset that will be leased when construction of the asset is completed. EITF 97-10 requires us to be considered the owner, for accounting purposes only, of these production facilities.

(c)

These properties are in our Europe segment. All other properties are included in our Americas segment.

In addition to the locations listed above, we maintain additional warehousing facilities in several of the states and countries where our manufacturing facilities are located. We consider our present facilities to be generally well maintained and in sound operating condition.

Item 3. *Legal Proceedings*

We are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. A negative outcome of these matters is considered remote, and management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

We are currently conducting an environmental cleanup at a formerly owned facility in South Brunswick, New Jersey pursuant to the New Jersey Industrial Site Recovery Act. We and one of our subsidiaries are parties to an Administrative Consent Order issued by the New Jersey Department of Environmental Protection. Pursuant to that order, we and our subsidiary agreed to conduct soil and groundwater remediation at the property. We do not believe that our manufacturing processes were the source of contamination. We sold the property in 1997. We and our subsidiary retained primary responsibility for the required remediation. We have completed essentially all soil remediation with the New Jersey Department of Environmental Protection's approval, and have installed a groundwater remediation system on the site. During 2005, with the approval from the New Jersey Department of Environmental Protection, we removed and disposed of sediment in Oakeys Brook adjoining the site. We continue to monitor groundwater remediation at this site. We have recorded a reserve as of November 30, 2008 of \$2.8 million (\$3.7 million prior to discounting at 4.75%) associated with this remediation project. Also in connection with this site, we received a written complaint from the New Jersey Department of Environmental Protection alleging natural resources damages in an unspecified amount. In November 2008, the trial court in this matter granted the Company's summary judgment motion and the time to appeal this ruling has passed.

We are also remediating soil and groundwater contamination at an inactive facility located in Oakville, Connecticut. Although we are conducting the remediation voluntarily, we obtained Connecticut Department of Environmental Protection approval of the remediation plan. We have completed essentially all soil remediation under the remediation plan and are currently monitoring groundwater at the site. We identified cadmium in the soil and ground water at the site and removed the cadmium contaminated soil and rock from the site during fiscal 2007. At November 30, 2008, we have recorded a reserve of approximately \$0.2 million associated with the additional work and ongoing monitoring. We believe the contamination is attributable to the manufacturing operations of previous unaffiliated occupants of the facility.

We removed three underground storage tanks previously used for diesel, gasoline, and waste oil from our South Gate, California facility in March 1994 and remediated the soil in the area. Since August 1998, we have been working with the California Regional Water Quality Control Board, Los Angeles Region to monitor groundwater at the site. On December 1, 2008, we sold this facility and the buyer assumed responsibility for the environmental issues related to the site.

While we cannot predict the ultimate timing or costs of the South Brunswick and Oakville environmental matters, based on facts currently known, we believe that the accruals recorded are adequate and do not believe the resolution of these matters will have a material adverse effect on our financial position or our future operations; 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 adverse effect.

Item 4. *Submission of Matters to a Vote of Security Holders*

None

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Our common stock trades on the New York Stock Exchange under the symbol "ZZ." The table below highlights quarterly stock market information and the amount of cash dividends declared per share of our common stock for the past two fiscal years.

	Sales Price (\$)		Cash Dividend Declared (\$)
	High	Low	
Fiscal 2008			
First quarter	13.39	8.87	0.075
Second quarter	9.14	5.63	—
Third quarter	7.90	5.12	—
Fourth quarter	8.41	1.62	—

	Sales Price (\$)		Cash Dividend Declared (\$)
	High	Low	
Fiscal 2007			
First quarter	18.00	14.28	0.075
Second quarter	18.13	16.00	0.075
Third quarter	17.15	13.95	0.075
Fourth quarter	15.60	11.80	0.075

Our ability to pay dividends is restricted by our debt agreements. See "Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7."

During fiscal 2008, a total of 3,396,805 options to purchase our common stock were granted to certain of our employees and non-employee directors under the Sealy Corporation 2004 Stock Option Plan. Options under the 2004 Plan are granted in part as: 1) "time options," which vest and become exercisable ratably on a monthly basis generally over the first three to five years following the date of grant; 2) "old performance options," which vest and become exercisable each fiscal year through fiscal 2008 upon the achievement of certain financial performance targets, and in any event by the eighth anniversary of the date of grant; and 3) "new performance options," issued during fiscal 2008 which vest and become exercisable only upon achievement of certain financial performance targets and do not have a time vesting component.

As of January 2, 2009, there were approximately 194 holders of record of our common stock.

Our common stock repurchase program, which authorizes us to repurchase up to \$100 million of our Company's common stock, was initially approved by our Board of Directors on February 19, 2007. During the fourth quarter of fiscal 2008, no shares were repurchased under this program. However, during the fourth quarter of fiscal 2008, 13,640 shares were surrendered or withheld to cover the exercise price and/or tax withholding obligations in stock option exercises, as permitted under the Company's 1998 and 2004 Stock Option Plans. See table below:

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased during quarter as part of publicly announced program	Approximate dollar value of shares that may yet be purchased under program
September 1 - September 28, 2008	13,640	\$ 7.47	—	\$ 83,746,985
September 29 - October 26, 2008	—	—	—	83,746,985
October 27 - November 30, 2008	—	—	—	83,746,985
Total	13,640	—	—	—

Item 6. Selected Financial Data

The following table presents selected historical financial and other data about us. The selected historical financial data for the years ended and as of November 30, 2008, December 2, 2007, November 26, 2006, November 27, 2005 and November 28, 2004 are derived from our audited Consolidated Financial Statements and the notes thereto. The consolidated financial statements for the three years ended November 30, 2008 have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, and are included in "Financial Statements and Supplementary Data" in Item 8 below.

The selected historical financial and other data set forth below should be read together with the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 below, and our financial statements and the notes thereto, appearing elsewhere in this report.

	Fiscal Year(1)				
	2008	2007	2006	2005	2004
	(in millions, except per share data)				
Statement of Operations Data:					
Net sales	\$ 1,498.0	\$ 1,702.1	\$ 1,582.8	\$ 1,469.6	\$ 1,314.0
Cost of goods sold	914.0	992.5	874.9	818.0	740.1
Selling, general and administrative expenses	482.6	545.6	499.6	456.3	430.9
Other (income) expense(2)	17.0	(15.2)	15.4	(12.7)	120.8
Income from operations	84.4	179.2	192.9	208.0	22.2
Interest expense	60.5	64.0	72.0	79.6	72.7
Other (income) expense, net	4.9	0.7	9.1	5.4	(0.8)
Income (loss) before provision for income taxes	19.0	114.5	111.8	123.0	(49.7)
Provision for income tax expense (benefit)	21.9	35.1	37.6	54.5	(9.6)
Income (loss) before cumulative effect of change in accounting principle	(2.9)	79.4	74.2	68.5	(40.1)
Cumulative effect of change in accounting principle, net of tax	—	—	0.3	—	—
Net income (loss)	(2.9)	79.4	73.9	68.5	(40.1)
Liquidation preference for common L&M shares	—	—	—	—	7.8
Income (loss) available to common shareholders	\$ (2.9)	\$ 79.4	\$ 73.9	\$ 68.5	\$ (47.9)
Basic net income (loss) per share:					
Net income (loss) per share	\$ (0.03)	\$ 0.87	\$ 0.89	\$ 0.97	\$ (0.53)
Cumulative effect of change in accounting principle	—	—	—	—	—
Liquidation preference for common L&M shares	—	—	—	—	(0.11)
Earnings per common share—Basic	\$ (0.03)	\$ 0.87	\$ 0.89	\$ 0.97	\$ (0.64)
Weighted average shares	91.2	91.3	83.6	70.4	75.3
Diluted net income (loss) per share:					
Net income (loss) per share	\$ (0.03)	\$ 0.82	\$ 0.83	\$ 0.91	\$ (0.53)
Cumulative effect of change in accounting principle	—	—	—	—	—
Liquidation preference for common L&M shares	—	—	—	—	(0.11)
Earnings (losses) per common share—Diluted	\$ (0.03)	\$ 0.82	\$ 0.83	\$ 0.91	\$ (0.64)
Weighted average shares	91.2	96.3	89.6	75.4	75.3

	Fiscal Year(1)				
	2008	2007	2006	2005	2004
(in millions, except per share data)					
Balance Sheet Data (at end of period):					
Current assets	\$ 295.6	\$ 343.7	\$ 345.3	\$ 304.4	\$ 300.0
Total assets	920.9	1,025.1	1,002.7	915.9	898.5
Current liabilities	238.5	321.9	288.2	282.0	255.2
Long term debt, net of current portion	762.2	757.3	814.2	959.8	1,043.6
Total debt	783.4	793.8	832.5	972.8	1,052.1
Common stock and options subject to redemption	8.9	16.2	20.3	21.6	—
Stockholders' deficit	(164.8)	(129.4)	(172.8)	(412.2)	(456.8)
Other Financial Data:					
Dividends per common share	\$ 0.08	\$ 0.30	\$ 0.23	\$ —	\$ —
Depreciation and amortization	34.0	30.5	30.2	21.9	25.4
Capital expenditures	(25.0)	(42.4)	(30.9)	(29.4)	(22.8)
Cash flows provided by (used in):					
Operating activities	53.7	94.4	58.2	135.0	43.5
Investing activities	(24.9)	(37.4)	(30.3)	(19.4)	(7.4)
Financing activities	(18.7)	(86.2)	(18.9)	(101.5)	(116.0)

(1) We use a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal years ended November 30, 2008, November 26, 2006, November 27, 2005 and November 28, 2004 were all 52-week years. The fiscal year ended December 2, 2007 was a 53-week year. All stock share amounts have been restated to reflect the 0.7595 to 1 reverse stock split, which became effective on March 23, 2006.

(2) Also includes the following items to the extent applicable for the periods presented: IPO expenses, recapitalization expenses, stock based compensation, goodwill impairment charge, business closure charge, plant closing and restructuring charges, amortization of intangibles, asset impairment charges and net royalty income.

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following management's discussion and analysis is provided as a supplement to, and should be read in conjunction with, our Consolidated Financial Statements and accompanying notes included in this filing. Except where the context suggests otherwise, the terms "we," "us" and "our" refer to Sealy Corporation and its subsidiaries.

Business Overview

We believe we are the largest bedding manufacturer in the world, with a domestic market share of approximately 20.9% in 2007. We believe our market share in 2008 is comparable to 2007. We manufacture and market a complete line of bedding (innerspring and non-innerspring) products, including mattresses and box springs, holding leading positions in key market categories such as luxury bedding products and among leading retailers. Our conventional bedding products include the *Sealy*, *Sealy Posturepedic*, *Stearns & Foster* and *Bassett* brands and accounted for approximately 87% of our total domestic net sales for the year ended November 30, 2008. In addition to our innerspring bedding, we also produce a variety of visco-elastic ("memory foam") and latex foam bedding products. We expect to experience continued market share growth in these product lines as we seek to strengthen our competitive position in the specialty bedding (non-innerspring mattress) market. We distinguish ourselves from our major competitors by maintaining our own component parts manufacturing capability and producing substantially all of our mattress innerspring and latex mattress components requirements and approximately half of our box spring component parts requirements.

The current economic and weak retail environments have affected the level of spending by end consumers and has caused a decrease in mattress sales across the industry. From January 2008 through November 2008, the total decrease in sales levels was 11.5% as reported by the International Sleep Products Association. We expect this challenging business environment to continue into 2009.

We have continued our focus on lean manufacturing principles which results in continuing improvements in our manufacturing processes and cost savings. Additionally, we continue to focus on new product development to bring new and innovative product to the market. In January 2008, we introduced our new *Sealy Posturepedic* innerspring line which is designed to eliminate tossing and turning caused by pressure points. This product line was designed in conjunction with orthopedic surgeons, and reviewed by an independent Orthopedic Advisory Board. In June 2008, we introduced a new line of specialty bedding products in the form of our *Sealy Posturepedic PurEmbrace* mattresses featuring our proprietary *SmartLatex*. This product line, as with our new *Sealy Posturepedic* product, was designed to eliminate pressure points that cause tossing and turning.

We have also invested capital in the business to increase our capability to design products. In 2008, we opened our new Center of Excellence pressure mapping laboratory which allows us to use the latest technologies available to identify uncomfortable pressure points. It also allows us to better quantify sleep quality and directly link it to sleep surfaces.

Our industry continues to be challenged by the unprecedented volatility in the price of petroleum-based and steel products, which affects the cost of our polyurethane foam, polyester, polyethylene foam and steel innerspring component parts. Domestic supplies of these raw materials are being limited by supplier consolidation, the exporting of these raw materials outside of the U.S. due to the weakened dollar and other forces beyond our control. During fiscal 2007 and 2008, the cost of these components saw significant increases above their recent historical averages. We expect these costs, particularly those related to steel and polyurethane and latex foams to decrease during fiscal 2009 due to an expected decline in related commodity prices, but these decreases may not occur. The manufacturers of products such as petro-chemicals and wire rod, which are the materials purchased by our suppliers of foam and

drawn wire, may reduce supplies in an effort to maintain higher prices. These actions would delay or eliminate price reductions from our suppliers.

We have continued to see sales growth in our international operations over the last several years, with our foreign subsidiaries contributing 29.5% of our total revenues during fiscal 2008. However, the economic slowdown we have been experiencing in the U.S. has begun to spread and we are experiencing a slowdown in international markets as well. Furthermore, changes in foreign exchange rates contributed favorably to international results and these trends have begun to reverse. Local currency sales declined in fiscal 2008 in Canada and Europe, our two largest international markets, and profits in these markets were also negatively impacted by rising raw material costs.

Raw Materials

The cost of our steel innerspring, polyurethane foam, polyester, and polyethylene component parts were impacted sharply by the volatility in the prices of steel and petroleum. We expect the cost of these components to decrease from the all-time highs experienced in our fiscal fourth quarter. During fiscal 2008, we entered into commodity-based physical contracts to buy natural gas at agreed-upon fixed prices. These contracts were entered into in the normal course of business. We do not engage in commodity hedging programs.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our Consolidated Financial Statements that have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP). The preparation of financial statements in accordance with US GAAP requires our management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. US GAAP provides the framework from which to make these estimates, assumptions and disclosures. We choose accounting policies within US GAAP that our management believes are appropriate to accurately and fairly report our operating results and financial position in a consistent manner. Our management regularly assesses these policies in light of current and forecasted economic conditions. Our accounting policies are stated in Note 1 to our Consolidated Financial Statements included in Item 8. We believe the following accounting estimates are critical to understanding our results of operations and affect the more significant judgments and estimates used in the preparation of our Consolidated Financial Statements:

Cooperative Advertising, Rebate and Other Promotional Programs—We enter into agreements with our customers to provide funds to the customer for advertising and promotion of our products. We also enter into volume and other rebate programs with our customers whereby funds may be rebated to the customer. When sales are made to these customers, we record liabilities pursuant to these agreements. We periodically assess these liabilities based on actual sales and claims to determine whether all of the cooperative advertising earned will be used by the customer or whether the customers will meet the requirements to receive rebate funds. We generally negotiate these agreements on a customer-by-customer basis. Some of these agreements extend over several periods and are linked with supply agreements. Most of these agreements coincide with our fiscal year; however, our customers typically have ninety days following the end of a period to submit claims for reimbursement of advertising and promotional costs. Therefore, significant estimates are required at any point in time with regard to the ultimate reimbursement to be claimed by our customers. Subsequent revisions to such estimates are recorded and charged to earnings in the period in which they are identified. Costs of these programs totaled \$235.0 million, \$275.7 million and \$247.9 million in fiscal 2008, 2007 and 2006, respectively. Of these costs, amounts associated with volume rebates, supply agreement amortization, slotting fees, end consumer rebates and other customer allowances which were recorded as a reduction

of sales were \$101.4 million, \$104.4 million and \$96.7 million in fiscal 2008, 2007 and 2006, respectively. The costs associated with cooperative advertising were recorded as selling, general and administrative expenses and were \$133.6 million, \$171.2 million and \$151.2 million in fiscal 2008, 2007 and 2006, respectively.

Allowance for Doubtful Accounts—During 2008, the economic environment became more challenging and caused a higher occurrence of bankruptcies for mattress retailers. It has also caused many of the smaller mattress retailers to exit the market. We actively monitor the financial condition of our customers to determine the potential for any nonpayment of trade receivables. In determining our reserve for bad debts, we also consider other general economic factors. Our management believes that our process of specific review of customers, combined with overall analytical review provides a reliable evaluation of ultimate collectibility of trade receivables. We recorded a bad debt provision of \$10.3 million, or approximately 0.7% percent of sales, in fiscal 2008. Provisions for bad debts recorded in fiscal 2007 and 2006 were \$6.6 million and \$2.7 million, respectively.

Warranties and Product Returns—Our warranty policy provides a 10 year non-pro rated warranty service period on all currently manufactured *Sealy Posturepedic, Stearns & Foster* and *Bassett* bedding products and some other *Sealy* branded products and a 20 year warranty period on the major components of our *TrueForm* and *MirrorForm* visco-elastic products as well as our *SpringFree* latex product, introduced in 2005, the last ten years of which are pro rated on a straight-line basis. In 2006, we introduced and subsequently discontinued *Right Touch*, which has a twenty year limited warranty that covers only certain parts of the product and is pro rated for part of the twenty years. In fiscal 2007, we amended our warranty policy on *Sealy* brand promotional bedding to three years for our new line introduced in January 2007 and shipped in the second quarter of fiscal 2007. The impact of the changes to the warranty policies did not have a significant impact on our financial results or position. Our policy is to accrue the estimated cost of warranty coverage at the time the sale is recorded based on historical trends of warranty costs. We utilize warranty trends on existing similar product in order to estimate future warranty claims associated with newly introduced product. Our accrued warranty liability totaled \$16.5 million and \$16.0 million as of November 30, 2008 and December 2, 2007, respectively.

In fiscal 2008, we completed an analysis of our returns claims experience for the U.S. business within the Americas segment based on historical return trends using new information that is available which allows us to better track and match claims received to the sales for which those claims were initially recorded. This change in estimate resulted in a reduction of cost of sales of approximately \$2.5 million for fiscal 2008 as well as a corresponding reduction in the accrued returns obligation. Our estimate involves an application of the lag time in days between the sale date and the date of its return applied to the current rate of returns.

Share-Based Compensation Plans—We have five share based compensation plans, as described more fully in Note 3 to our Consolidated Financial Statements included in Item 8. We have adopted the provisions of FAS No. 123 (revised 2004) "Share-Based Payment" (FAS 123(R)). For new awards issued and awards modified, repurchased, or cancelled, the cost is equal to the fair value of the award at the date of the grant, and compensation expense is recognized for those awards earned over the service period. Certain of the equity awards vest based upon the Company achieving certain EBITDA performance targets. During the service period, management estimates whether or not the EBITDA performance targets will be met in order to determine the vesting period for those awards and what amount of compensation cost should be recognized related to these awards. At the date of grant, we determine the fair value of the awards using the Black-Scholes option pricing formula or the trinomial lattice model, as appropriate under the circumstances. Management estimates the period of time the employee will hold the option prior to exercise and the expected volatility of Sealy Corporation's stock,

each of which impacts the fair value of the stock options. The fair value of restricted shares is based upon the closing price of the Company's common stock as of the grant date.

Self-Insurance Liabilities—We are self-insured for certain losses related to medical claims with excess loss coverage of \$375,000 per claim per year. The Company also utilizes large deductible policies to insure claims related to general liability, product liability, automobile, and workers' compensation. Our recorded liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet date. The estimated liability is discounted and is established based upon analysis of historical data and actuarial estimates, and is reviewed by us and third-party actuaries on a quarterly basis to ensure that the liability is appropriate. While management believes these estimates are reasonable based on the information currently available, if actual trends, including the severity or frequency of claims, medical cost inflation, or fluctuations in premiums, differ from our estimates, our results of operations could be impacted. During fiscal 2008, we recognized a reduction of reserves of \$1.3 million. This was in part due to a continued reduction in the severity and number of claims. Also contributing to the decrease in the reserve was a prepayment of claims that was made prior to November 30, 2008. During fiscal 2007, we recognized a reduction of reserves totaling \$0.9 million due to favorable loss development from a reduction in both the frequency and severity of historical claims experience. During fiscal 2006, we recognized a reduction of reserves totaling \$5.7 million, which included a \$2.3 million change in estimate due to a change from industry loss development factors to our own historical loss development factors. The remaining change relates to favorable loss development due to a reduction in both the frequency and severity of historical claims experience. All such charges relate to plant labor and are therefore included in cost of goods sold for the period.

Impairment of Goodwill—We assess goodwill at least annually for impairment as of the beginning of the fiscal fourth quarter or whenever events or circumstances indicate that the carrying value of goodwill may not be recoverable from future cash flows. We assess recoverability using several methodologies, including the present value of estimated future cash flows and comparisons of multiples of enterprise values to earnings before interest, taxes, depreciation and amortization (EBITDA). The analysis is based upon available information regarding expected future cash flows of each reporting unit discounted at rates consistent with the cost of capital specific to the reporting unit. If the carrying value of the reporting unit exceeds the indicated fair value of the reporting unit, a second analysis is performed to measure the fair value of all assets and liabilities. If, based on the second analysis, it is determined that the implied fair value of the goodwill of the reporting unit is less than the carrying value, goodwill is considered impaired.

In the fourth quarter of fiscal 2008, market conditions deteriorated significantly. This deterioration resulting from the global economic downturn had not yet matured or been considered in our annual test of goodwill. Because of the potential impact of these conditions on our projections and the indicated fair value of our reporting units, we performed an interim evaluation of goodwill in the fourth quarter of 2008 reflecting our current views regarding the impact of the changed economic environment. This analysis indicated potential impairment in the goodwill of our Europe and Puerto Rico reporting units. As a result, we estimated the implied fair value of the goodwill in those reporting units compared to carrying amounts and recorded an impairment charge of \$27.5 million to impair goodwill of \$2.8 million recorded in the Puerto Rico reporting unit and \$24.7 million in the Europe reporting unit. This impairment charge is based upon estimates of the fair value of property and equipment and certain intangible assets, including customer relationships. We will finalize these estimates in the first quarter of fiscal 2009.

The expected volatility in the price of our steel and petroleum-based components and the current uncertainty in the credit and equity markets may impact the estimates used in evaluating goodwill and indefinite lived intangible assets for potential impairment. In light of these changes in market conditions, we will continue to monitor impairment indicators across our reporting units. The total

carrying value of our goodwill was \$357.1 million and \$395.5 million at November 30, 2008 and December 2, 2007, respectively.

Commitments and Contingencies—We are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. A negative outcome of these matters is considered remote, and management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Income Taxes—We record an income tax valuation allowance when the realization of certain deferred tax assets, including net operating losses and capital loss carryforwards, is not more likely than not. These deferred tax items represent expenses recognized for financial reporting purposes, which may result in tax deductions in the future. Certain judgments, assumptions and estimates may affect the carrying value of the valuation allowance and income tax expense in the Consolidated Financial Statements. Our net deferred tax assets at November 30, 2008 were \$15.2 million, net of a \$27.9 million valuation allowance.

Effective December 3, 2007, we adopted the provisions of FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" ("FIN 48"), as described in Note 1 to the Consolidated Financial Statements included in Item 8 herein. Significant judgment is required in evaluating our federal, state and foreign tax positions and in the determination of our tax provision. Despite our belief that our liability for unrecognized tax benefits is adequate, it is often difficult to predict the final outcome or the timing of the resolution of any particular tax matters. We may adjust these liabilities as relevant circumstances evolve, such as guidance from the relevant tax authority, our tax advisors, or resolution of issues in the courts. These adjustments are recognized as a component of income tax expense entirely in the period in which they are identified.

Conditional Asset Retirement Obligations—In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143" ("FIN 47"). This interpretation clarifies the term "conditional asset retirement obligation" as used in FAS 143 and provides additional guidance on the timing and method for the recognition and measurement of such conditional obligations. FIN 47 became effective for fiscal years ending after December 15, 2005. We adopted FIN 47 as of the beginning of fiscal 2006 and have recorded an adjustment as of November 28, 2005, the first day of fiscal 2006, of approximately \$0.3 million, net of income tax benefit of \$0.2 million, to recognize the cumulative effect of the accounting change. In addition, we recorded \$0.1 million in property, plant and equipment and a liability of \$0.6 million in other noncurrent liabilities as of November 28, 2005. During fiscal 2008, 2007 and 2006, we recognized an additional \$0.3 million, \$0.1 million, and \$0.3 million, respectively, in property, plant and equipment and other noncurrent liabilities for leases entered into during the year. We also recognized accretion expense of \$0.1 million during fiscal 2008 and 2007. An insignificant amount of accretion expense was recognized during fiscal 2006. These resulted from obligations in certain of our facility leases that require us to return those properties to the same or similar condition at the end of the lease as existed when we began using those facilities. Although the lease termination dates range from 2009 to 2023, we may be able to renegotiate such leases to extend the terms.

In addition to the above obligations, we also own certain factories that contain asbestos. Current regulations require that we remove and dispose of asbestos if the factory undergoes major renovations or is demolished. Although we are not required to remove the asbestos unless renovation or demolition occurs, we are required to monitor and ensure that it remains stable and notify any potential buyer of its existence. In the fourth quarter of 2006, we recognized an asset retirement obligation of \$0.1 million to remove asbestos at a U.S. facility that was renovated in the second quarter of fiscal 2007. Also, in fiscal 2007, we removed asbestos at a European facility. We have recognized an asset retirement obligation of \$0.2 million for the remaining asbestos in our European facilities. We have not recognized asset retirement obligations in our financial statements for asbestos at any other facilities because

management believes that there is an indeterminate settlement date for the retirement obligation as the range of time over which we may be required to remove and dispose of the asbestos is unknown or cannot be estimated. We currently have no plans to demolish a factory or to undertake a major renovation that would require removal of the asbestos at any of these other facilities. Management will continue to monitor this issue and will record an asset retirement obligation when sufficient information becomes available to estimate the obligation.

Initial Public Offering

On April 12, 2006, we completed an initial public offering ("IPO") of our common stock, raising \$299.2 million of net proceeds after deducting the underwriting discount. We used a portion of the proceeds to pay a cash dividend to shareholders of record immediately prior to the IPO of \$125 million. We also used a portion of the proceeds from the IPO to repurchase and retire \$47.5 million aggregate principal amount of our 8.25% senior subordinated notes due June 2014 (the "2014 Notes") in a series of open market transactions completed on April 26, 2006 at prices ranging from 105.25% to 105.92% of par, plus accrued interest. On April 21, 2006, we used approximately \$90.0 million of IPO proceeds to redeem the entire outstanding balance of the senior subordinated pay-in-kind notes ("PIK Notes"), along with accrued interest and prepayment penalties through the date of the redemption. For a detailed presentation of the sources and uses of cash from the IPO, see Note 2 to our Consolidated Financial Statements, included in Item 8.

Merger and Recapitalization

On April 6, 2004, we completed a merger with an entity owned by affiliates of KKR whereby KKR acquired approximately 92% of our capital stock. Certain of our stockholders prior to the merger, including affiliates of Bain Capital, LLC and others, which we refer to collectively as Rollover Stockholders, retained approximately an 8% interest in our capital stock. Additionally, we refinanced our existing credit agreements in connection with this merger. Subsequently on September 29, 2004, Sealy Mattress Company (a 100% owned subsidiary of the Company), completed an exchange offer whereby all of the senior subordinated notes were exchanged for publicly traded, registered securities with identical terms (other than certain terms relating to registration rights and certain interest rate provisions otherwise applicable to the original senior subordinated notes).

Results of Operations

Tabular Information

The following table sets forth our summarized results of operations for fiscal years 2008, 2007 and 2006, expressed in thousands of dollars as well as a percentage of each year's net sales:

	Fiscal year(1)					
	2008		2007		2006	
	(in thousands)	(percentage of net sales)	(in thousands)	(percentage of net sales)	(in thousands)	(percentage of net sales)
Net sales	\$ 1,498,023	100.0%	\$ 1,702,065	100.0%	\$ 1,582,843	100.0%
Cost of goods sold(2)	913,982	61.0	992,455	58.3	874,927	55.3
Gross profit	584,041	39.0	709,610	41.7	707,916	44.7
Selling, general and administrative expenses(2)	482,566	32.2	545,608	32.1	499,614	31.6
Expenses associated with IPO	—	—	—	—	28,510	1.8
Goodwill impairment loss	27,475	1.8	—	—	—	—
Amortization of intangibles	3,692	0.2	3,356	0.2	5,707	0.4
Restructuring expenses	3,126	0.2	—	—	—	—
Royalty income, net of royalty expense	(17,327)	(1.2)	(18,562)	(1.1)	(18,855)	(1.2)
Income from operations	84,509	5.8	179,208	10.5	192,940	12.1
Interest expense	60,464	4.0	63,976	3.8	71,961	4.5
Debt extinguishment and refinancing	5,378	0.4	1,222	0.1	9,899	0.6
Other income, net	(397)	—	(421)	—	(750)	—
Income before income taxes and cumulative effect	19,064	1.4	114,431	6.6	111,830	7.0
Income taxes	21,931	1.5	35,058	2.1	37,576	2.4
Income before cumulative effect of change in accounting principle	(2,867)	(0.1)	79,373	4.5	74,254	4.6
Cumulative effect of change in accounting principle	—	—	—	—	287	—
Net income (loss)	\$ (2,867)	(0.1)%	\$ 79,373	4.5%	\$ 73,967	4.6%
Effective tax rate	115.0%		30.6%		33.6%	

(1) We use a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal years ended November 30, 2008 and November 26, 2006 were 52-week years. The fiscal year ended December 2, 2007 was a 53-week year.

(2) Included in our selling, general and administrative expenses for fiscal years 2008, 2007 and 2006 were \$91.1 million, \$91.2 million, and \$80.7 million, respectively, in shipping and handling costs associated with the delivery of finished mattress products to our customers, including approximately \$7.3 million, \$8.4 million and \$8.6 million, respectively, of costs associated with internal transfers between our plant locations. With respect to these costs, our cost of goods sold may not be comparable with that reported by other entities.

The following table indicates the percentage distribution of our net sales in U.S. dollars throughout our international operations:

Geographic distribution of sales:

	Fiscal year(1)		
	2008	2007	2006
Americas:			
United States	70.5%	74.5%	76.4%
Canada	12.5	11.5	10.6
Other	7.1	5.8	5.3
Total Americas	90.1	91.8	92.3
Europe	9.9	8.2	7.7
Total	100.0%	100.0%	100.0%

(1)

We use a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal years ended November 30, 2008 and November 26, 2006 were 52-week years. The fiscal year ended December 2, 2007 was a 53-week year.

The following table shows our net sales and margin profitability for the major geographic regions of our operations, including local currency results for the significant international operations:

	Fiscal year(1)					
	2008		2007		2006	
	(in thousands)	(percentage of net sales)	(in thousands)	(percentage of net sales)	(in thousands)	(percentage of net sales)
Total Americas (US Dollars):						
Net sales	\$ 1,349,283	100.0%	\$ 1,561,739	100.0%	\$ 1,460,972	100.0%
Cost of goods sold	799,026	59.2	887,975	56.9	788,221	54.0
Gross profit	550,257	40.8	673,764	43.1	672,751	46.0
United States (US Dollars):						
Net sales	1,055,682	100.0	1,266,355	100.0	1,209,012	100.0
Cost of goods sold	626,678	59.4	719,537	56.8	645,131	53.4
Gross profit	429,004	40.6	546,818	43.2	563,881	46.6
Total International (US Dollars):						
Net sales	442,341	100.0	435,710	100.0	373,831	100.0
Cost of goods sold	287,304	65.0	272,918	62.6	229,796	61.5
Gross profit	155,037	35.0	162,792	37.4	144,035	38.5
Canada:						
US Dollars:						
Net sales	187,672	100.0	196,264	100.0	167,763	100.0
Cost of goods sold	108,795	58.0	111,737	56.9	93,699	55.9
Gross profit	78,877	42.0	84,527	43.1	74,064	44.1
Canadian Dollars:						
Net sales	195,373	100.0	210,724	100.0	190,371	100.0
Cost of goods sold	113,431	58.1	120,004	56.9	106,336	55.9
Gross profit	81,942	41.9	90,720	43.1	84,035	44.1
Other Americas (US Dollars):						
Net sales	105,929	100.0	99,120	100.0	84,197	100.0
Cost of goods sold	63,553	60.0	56,701	57.2	49,391	58.7
Gross profit	42,376	40.0	42,419	42.8	34,806	41.3
Europe:						
US Dollars:						
Net sales	148,740	100.0	140,326	100.0	121,871	100.0
Cost of goods sold	114,956	77.3	104,480	74.5	86,706	71.1
Gross profit	33,784	22.7	35,846	25.5	35,165	28.9
Euros:						
Net sales	99,699	100.0	103,350	100.0	97,982	100.0
Cost of goods sold	76,947	77.2	76,885	74.4	69,530	71.0
Gross profit	22,752	22.8%	26,465	25.6%	28,452	29.0%

(1)

We use a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal years ended November 30, 2008 and November 26, 2006 were 52-week years. The fiscal year ended December 2, 2007 was a 53-week year.

Year Ended November 30, 2008 Compared With Year Ended December 2, 2007

Net Sales. Our consolidated net sales for the year ended November 30, 2008 were \$1,498.0 million, a decrease of \$204.0 million, or 12.0% from the year ended December 2, 2007. Fiscal

year 2007 was a 53 week year, while fiscal year 2008 was a 52 week year. The decrease in net sales attributable to the 53rd week in fiscal 2007 was \$32.3 million or 1.9% of fiscal 2007 net sales. Total Americas net sales were \$1,349.3 million for fiscal 2008, a decrease of 13.6% from fiscal 2007. This decrease was primarily related to our U.S. operations within the Americas segment. Total U.S. net sales of \$1,055.7 million for fiscal 2008 declined \$210.7 million from \$1,266.4 million in fiscal 2007, a decrease of 16.6%. The net sales attributable to the 53rd week in 2007 for the U.S. were \$26.2 million. The U.S. net sales decrease of \$210.7 million was attributable primarily to a 19.0% decrease in wholesale unit volume, partially offset by a 1.6% increase in wholesale average unit selling price. The decrease in unit volume was affected by weak retail demand, which intensified in our fiscal fourth quarter. Sales of our new *Posturepedic*, *SmartLatex* and *Sealy* branded products outperformed the rest of the portfolio. The slight increase in average unit selling price was due in part to the price increases taken in December 2007 and July 2008. Average unit selling price was also favorably impacted by the \$3.7 million favorable impact from the change in the estimated reserve for non-warranty product returns. Partially offsetting these favorable effects was the impact of increased floor sample discounts related to new product introductions as well as softer sales of higher price point products such as *Stearns & Foster*. In Canada, local currency sales decreases of 7.3% translated into decreases of 4.4% in U.S. dollars as retail demand in this market increasingly deteriorated during the year. Local currency sales decreases in our Canadian market were driven by a 7.5% decrease in unit volume, offset by a 0.2% increase in average unit selling price. The decrease in unit volume is primarily attributable to declines brought about because of a weak retail environment in this market. Elsewhere in the Americas, we experienced sales gains in our Mexico and Argentina markets. However, retail demand in these markets has also begun to decline. In our Europe segment, local currency sales decreases of 3.5% translated into an increase of 6.0% in U.S. dollars. Local currency sales decreases in the European market were attributable to an 11.5% decrease in unit volume driven by decreased sales of latex bed cores to other manufacturers, partially offset by a 9.0% increase in average unit selling price associated with price increases to our customers to offset some of the increased cost of raw materials. Finished goods sales in Europe decreased 3.4% in local currency in fiscal 2008.

Gross Profit. Gross profit for fiscal 2008 was \$584.0 million, a decrease of \$125.6 million compared to fiscal 2007. The 2007 results include the impact of the 53rd week, which represented \$13.1 million. As a percentage of net sales, gross profit in fiscal 2008 decreased 2.7 percentage points to 39.0%. This was due to a decrease in gross profit margins within both of our segments. Total Americas gross profit in fiscal 2008 decreased \$123.5 million to \$550.3 million, which as a percentage of sales, represented a decrease of 2.3 percentage points to 40.8%. The decrease in gross profit for the Americas segment was primarily driven by a decrease in the U.S. gross profit in fiscal 2008. U.S. gross profit decreased \$117.8 million to \$429.0 million or 40.6% of net sales, which is a decrease of 2.6 percentage points of net sales from the prior year period. The decrease in percentage of net sales was driven primarily by higher inflation on core inputs such as steel and foam. In addition, the domestic gross profit margin relative to the prior year was negatively impacted by less absorption of overhead expenses due to lower volume and reduced sales of higher price point products such as *Stearns & Foster*. Additionally, incremental costs of approximately \$8.1 million were incurred in fiscal 2008 as compared to fiscal 2007 related to compliance with July 2007 federal flame retardant regulations. The U.S. gross profit was positively impacted by a change in accounting estimate related to our warranty returns reserves recorded in the second quarter of fiscal 2008 which resulted in a reduction of cost of sales of approximately \$2.5 million. Also, U.S. gross profit was positively impacted by continued improvements in manufacturing efficiencies, particularly factory labor and product scrap costs. The results of fiscal 2007 include \$2.5 million of refunds on lumber tariffs received from Canadian suppliers (see Note 18 of the Consolidated Financial Statements in Item 8) as well as \$2.1 million more startup costs associated with the latex facility in Mountain Top, Pennsylvania. In Canada, our gross profit margin decreased 1.1 percentage points to 42.0% of net sales primarily due to less absorption of overhead expenses due to lower sales volumes and rising material costs. In our

Europe segment, the gross profit margin decrease resulted from manufacturing inefficiencies experienced related to lower production volume and price competition experienced in the OEM business.

Selling, General, and Administrative. Selling, general, and administrative expenses decreased \$63.0 million to \$482.6 million for fiscal 2008 compared to \$545.6 million for fiscal 2007. As a percentage of net sales, selling, general, and administrative expenses was 32.2% for fiscal 2008 compared to 32.1% for fiscal 2007. The decrease in selling, general and administrative expenses is primarily due to \$41.3 million of lower volume driven variable expenses and reductions in fixed costs. Actions taken to reduce fixed costs included \$14.4 million of reductions in compensation related expenses, and \$12.9 million less promotional expenses related to more efficient launches of new products in the U.S. as compared to fiscal 2007. In addition, spending on professional services and other discretionary items declined relative to fiscal 2007. Reduced sales drove a reduction of \$41.3 million in volume variable expenses comprised of a \$37.6 million decrease in cooperative advertising costs partially offset by higher transportation costs, a \$3.7 million increase in bad debt costs and the impact of significantly higher foreign currency valuations relative to the U.S. dollar. The fixed cost reductions were partially offset by \$6.6 million of costs associated with a reduction in personnel and executive search costs. The selling, general and administrative expense recorded in fiscal 2007 also reflected the gain on the sale of our Orlando facility of \$2.6 million as well as \$3.9 million of costs associated with an organizational realignment.

Goodwill impairment loss. During fiscal 2008, we recognized a total non-cash charge of \$27.5 million related to the impairment of goodwill of our Puerto Rico and Europe reporting units. The impairment was indicated by an update to our fiscal 2008 annual impairment testing of goodwill performed in the fourth quarter of fiscal 2008. The goodwill impairment reflected an estimated reduction in the fair value of Puerto Rico and Europe as a result of lower expected cash flows for the business and represents the entire goodwill balances for those reporting units. We will complete our analysis of these fair values in the first quarter of fiscal 2009 and reflect any change in the estimate at that time, if necessary. No such impairments were identified in fiscal 2007.

Restructuring and related costs. We recognized pretax restructuring costs of \$3.1 million during the year ended November 30, 2008. No such costs were recognized during the year ended December 2, 2007. These charges primarily relate to the following actions:

In the first quarter of fiscal 2008, management made the decision to cut back the manufacturing operations in Brazil and move to a business model under which significantly more product will be supplied by production from other Sealy manufacturing facilities. As a result, the Company incurred charges of \$0.5 million related to employee severance and related benefits. The Company does not expect to incur additional restructuring charges related to this activity. The plan was completed in the fourth quarter of fiscal 2008.

In the third quarter of fiscal 2008, management elected to close its administrative offices near Milan, Italy and relocate these activities to its manufacturing facility in Silvano, Italy. This closure resulted in the elimination of approximately 10 employees who elected not to relocate in the fourth quarter of fiscal 2008. We recorded a pre-tax restructuring charge related to this action of \$0.2 million during the year ended November 30, 2008, the majority of which related to employee severance and benefits. An insignificant amount of this charge was related to relocation costs. This plan was completed in the fourth quarter of fiscal 2008.

In the third quarter of fiscal 2008, management also made the decision to close its manufacturing facility in Clarion, Pennsylvania. This facility was closed on October 17, 2008. This closure resulted in the elimination of approximately 114 positions, the majority of which occurred in the fourth quarter of fiscal 2008. We recorded a pre-tax restructuring and impairment charge related to this action of \$2.5 million during fiscal 2008, of which \$1.6 million was related to employee severance and benefits

and other exit costs, and \$0.9 million of which was non-cash in nature, related to fixed asset impairment charges. The impairment charges were recognized based on the difference between the carrying value and the amount expected to be recovered through sale of the property, plant and equipment. The Company expects to incur additional restructuring charges related to this activity of approximately \$0.1 million to \$0.2 million, principally in the form of relocation costs, which are expected to be recorded in first quarter of fiscal 2009, after which time the plan should be complete.

Royalty Income, net of royalty expense. Our consolidated royalty income, net of royalty expense, for fiscal 2008 decreased \$1.2 million to \$17.3 million from fiscal 2007, primarily due to a decrease in international licensee sales.

Interest Expense. Our consolidated interest expense in fiscal 2008 decreased \$3.5 million from fiscal 2007. Our weighted average borrowing costs for fiscal 2008 and 2007 were 7.5% and 7.8%, respectively. Our borrowing cost and the related interest expense decreased because of lower interest rates on the unhedged variable rate component of our floating rate debt offset partially by an increase in the outstanding amount on our revolving credit facility. The borrowing cost was also reduced because of the retirement of \$68.1 million of our 2014 Notes late in fiscal 2007.

Debt Extinguishment and Refinancing Expenses. During fiscal 2008, we incurred cash charges of \$5.4 million related to the amendment of our senior credit facility which represents amounts paid to the creditors in connection with the amendment. During fiscal 2007, we incurred \$1.2 million of debt extinguishment costs consisting of \$1.7 million of non-cash charges offset by a \$0.5 million gain related to the retirement of \$68.1 million of our 2014 Notes.

Income Tax. Our effective income tax rate generally differs from the federal statutory rate due to the effects of certain foreign tax rate differentials and state and local income taxes. Our effective tax rate for fiscal 2008 and fiscal 2007 was 115.0% and 30.6%, respectively. The effective rate for the fiscal 2008 period was increased by 84.4% due to lower pre-tax income and the impairment of goodwill for our Puerto Rico and Europe reporting units which is not tax deductible. The effective rate for the fiscal 2007 period was reduced by a benefit of approximately \$4.4 million resulting from a reduction in our income tax reserve as a result of the elimination of certain federal and state tax exposures due to the expiration of statutes of limitations and approximately \$1.8 million from the reduction of the valuation allowance on capital loss carryforwards due to the availability of capital gains, and the reversal of previously established valuation allowances for Mexican deferred tax assets, partially offset by valuation allowances established during the year.

Year Ended December 2, 2007 Compared With Year Ended November 26, 2006

Net Sales. Our consolidated net sales for the year ended December 2, 2007 were \$1,702.1 million, an increase of \$119.2 million, or 7.5% from the year ended November 26, 2006. Fiscal year 2006 was a 52 week year, while fiscal year 2007 was a 53 week year. The increase in net sales attributable to the 53rd week was \$32.3 million. Total Americas net sales were \$1,561.7 million for fiscal 2007, an increase of 6.9% over fiscal 2006. This increase was primarily related to our U.S. and Canadian operations within the Americas segment. Total U.S. net sales were \$1,266.4 million for fiscal 2007 compared to \$1,209.0 million for fiscal 2006. In response to the challenging market conditions in the U.S. bedding industry and increased competition in the luxury portion of the market, our focus has been on driving unit volume. By driving unit volume, we were able to maintain the number of slots on the floors of our retail customers. We believe that by maintaining these slots, we are in a better position to take advantage of any improvement in industry conditions, and more importantly, insure that we will have sufficient distribution points for new products. This strategy drove a U.S. net sales increase of \$57.3 million which was attributable to an 8.8% increase in unit volume, partially offset by a 3.7% decrease in average unit selling price. The increase in unit volume is primarily attributable to the strong performance of our *Sealy* brand promotional product sales, which were up 16% from the prior year

period, and growth of our specialty bedding product sales, which increased 64% over the comparable prior year period. The decrease in our average unit selling price is primarily due to the higher volume of lower priced mattresses, such as our *Sealy* brand promotional products and lower sales of higher priced luxury innerspring products. In addition, strategic pricing actions were taken on selected products such as the *Stearns & Foster* and *TrueForm* lines to drive unit volume. In Canada, local currency sales gains of 10.7% translated into gains of 17.0% in U.S. dollars. Local currency sales gains in our Canadian market were driven by a 16.2% increase in unit volume, combined with a 4.8% decrease in average unit selling price. The changes in unit volume and average unit selling price were the result of selective pricing actions and promotional activity with national accounts. Elsewhere in the Americas, we experienced sales gains in our Mexico and Argentina markets. In our Europe segment, local currency sales gains of 5.5% translated into an increase of 15.1% in U.S. dollars. Local currency sales gains in the European market were attributable to a 67.5% increase in unit volume driven by increased sales of latex bed cores to other manufacturers, combined with a 37.0% decrease in average unit selling price associated with the increased sales of lower priced latex bed cores. Finished goods sales in Europe increased 7.0% in local currency or 16.3% in U.S. dollars in fiscal 2007.

Gross Profit. Gross profit for fiscal 2007 was \$709.6 million, an increase of \$1.7 million compared to fiscal 2006. The 2007 results include the impact of the 53rd week, which represented \$13.1 million. As a percentage of net sales, gross profit decreased 3.0 percentage points to 41.7%. This was due primarily to a decrease in our U.S. and Canada gross profit margins within our Americas segment. Total Americas gross profit increased \$1.0 million to \$673.8 million, which as a percentage of sales, represented a decrease of 2.9 percentage points to 43.1%. U.S. gross profit decreased \$17.1 million to \$546.8 million or 43.2% of net sales, which is a decrease of 3.4 percentage points of net sales from the prior year period. This decrease in percentage of net sales was driven by the addition of \$26.4 million of flame retardant materials to our products, the change in product mix and strategic pricing actions mentioned above and \$2.6 million of start-up costs associated with the new latex facility in Mountain Top, Pennsylvania. In addition, 2006 results included a \$5.7 million favorable adjustment due to changes in estimates underlying the reserves for workers' compensation claims in 2006 and prior years. Partially offsetting these effects were continued improvements in our manufacturing efficiencies, lower employee health insurance costs arising from our transition to a new third party administrator, as well as \$2.5 million of refunds on lumber tariffs received from Canadian suppliers (see Note 18 of the Consolidated Financial Statements in Item 8). On a per unit basis, U.S. material costs increased 5.1% over the prior year due primarily to additional costs to make our products compliant with the 2007 federal flame retardancy regulations, partially offset by improved yield on raw materials. In Canada, our gross profit margin decreased 1.0 percentage points to 43.1% of net sales primarily due to pricing actions taken that reduced average unit selling prices. In our Europe segment, the gross profit margin decrease resulted from increased sales of lower priced latex bed cores to other manufacturers, which carry a lower unit price and gross margin.

Selling, General, and Administrative. Selling, general, and administrative expenses increased \$46.0 million to \$545.6 million for fiscal 2007 compared to \$499.6 million for fiscal 2006. As a percentage of net sales, selling, general, and administrative expenses were 32.1% and 31.6% for the years ended December 2, 2007 and November 26, 2006. This increase as a percent of sales is primarily due to \$34.7 million of volume driven variable expenses, including a \$20.1 million increase in cooperative advertising costs and a \$10.5 million increase in delivery costs due primarily to higher unit volume. Other cost increases included a \$4.7 million increase in promotional expenses in the U.S. operations associated with the 2007 roll out of our new *Posturepedic* Reserve products and *Stearns & Foster* product line and other promotional expenses, a \$6.4 million increase in spending on national advertising and \$3.9 million of costs associated with an organizational realignment in the U.S. This increase was partially offset by a \$2.9 million reduction in compensation and other sales and administration costs in addition to a gain on the sale of our Orlando facility of \$2.6 million.

Expenses Associated With IPO. During fiscal 2006, we incurred \$34.2 million of expenses directly related to the IPO, which included approximately \$17.5 million of transaction related bonuses paid to management employees and \$11.0 million paid to KKR for the termination of the Management Services Agreement, and \$5.7 million in expenses related to debt retirement and non-cash compensation. (see Note 2 of the Consolidated Financial Statements in Item 8).

Royalty Income, net of royalty expense. Our consolidated royalty income, net of royalty expense, for fiscal 2007 decreased \$0.3 million to \$18.6 million from fiscal 2006, primarily due to a decrease in international royalty revenue.

Interest Expense. Our consolidated interest expense in fiscal 2007 decreased \$8.0 million from fiscal 2006, primarily due to lower debt levels resulting from \$46.6 million in voluntary prepayments of our senior term debt since November 27, 2005, the retirement of \$89.1 million of PIK Notes and \$47.5 million of the 2014 Notes in the second quarter of fiscal 2006 using proceeds from the IPO as well as the retirement of \$68.1 million of the 2014 Notes in fiscal 2007. These reductions were partially offset by slightly higher borrowing costs. Our weighted average borrowing costs for fiscal 2007 and 2006 were 7.8% and 7.7%, respectively.

Debt Extinguishment and Refinancing Expenses. During fiscal 2007, we incurred \$1.2 million of debt extinguishment costs consisting of \$1.7 million of non-cash charges offset by a \$0.5 million gain relating to the retirement of \$68.1 million of our 2014 Notes. During fiscal 2006, we incurred \$9.9 million of debt extinguishment costs consisting of \$3.6 million of cash expenses and \$1.7 million of non-cash charges related to the extinguishment of debt retired using proceeds from the IPO as well as \$0.5 million of cash expenses and \$4.1 million of non-cash charges related to the refinancing of our senior term debt in August, 2006.

Income Tax. Our effective income tax rate generally differs from the federal statutory rate due to the effects of certain foreign tax rate differentials and state and local income taxes. Our effective tax rate for fiscal 2007 and fiscal 2006 was 30.6% and 33.6%, respectively. The effective rate for the fiscal 2007 period was reduced by a benefit of approximately \$4.4 million resulting from a reduction in our income tax reserve as a result of the elimination of certain federal and state tax exposures due to the expiration of statutes of limitations and approximately \$1.8 million from the reduction of the valuation allowance on capital loss carryforwards due to the availability of capital gains, and the reversal of previously established valuation allowances for Mexican deferred tax assets, partially offset by valuation allowances established during the year. The effective rate for the fiscal 2006 period was reduced by a benefit of approximately \$2.7 million resulting from a reduction in our income tax reserve as a result of the elimination of certain federal and state tax exposures and approximately \$1.4 million from the reduction of the valuation allowance on capital loss carryforwards due to the availability of capital gains.

Liquidity and Capital Resources

Principal Sources of Funds

Our principal sources of funds are cash flows from operations and borrowings under our senior secured revolving credit facility. Our principal uses of funds consist of operating expenditures, payments of principal and interest on our senior credit agreements, capital expenditures, and interest payments on our outstanding senior subordinated notes. Capital expenditures totaled \$25.0 million for the year ended November 30, 2008 and we expect the level of capital expenditures to reduce significantly in fiscal 2009. During fiscal 2008, there was no significant spending for additional production capacity. We believe that annual capital expenditure limitations in our current credit agreements will not prevent us from meeting our ongoing capital needs. Our introductions of new products typically require us to make initial cash investments in inventory, promotional supplies and employee training which may not

be immediately recovered through new product sales. However, we believe that we have sufficient liquidity to absorb such expenditures related to new products and that these expenses will not have a significant adverse impact on our operating cash flow. At November 30, 2008, we had approximately \$44.7 million available under our revolving credit facility, which is scheduled to mature in 2010, after taking into account letters of credit issued totaling \$15.9 million. Our net weighted average borrowing cost was 7.5% and 7.8% for the years ended November 30, 2008 and December 2, 2007, respectively.

Due to concern over our ability to remain in compliance with our maximum leverage and minimum interest coverage ratios under our senior credit facility, we entered into the Second Amendment to the Third Amended and Restated Credit Agreement on November 14, 2008. This amendment loosened the restrictions provided by these ratios in the near term. These ratios are currently 5.85 times for the maximum leverage ratio and 2.00 for the minimum interest coverage ratio and become more restrictive over time under the amended agreement and reduce to 4.00 times for the maximum leverage ratio and increase to 2.75 times for the minimum interest coverage ratio by June 2010. In connection with the amendment, we paid an amendment fee to the lenders of \$3.9 million which represents 75 basis points on the outstanding balance under the senior credit facility as well as an arrangement fee of approximately \$1.5 million. Additionally, the amendment had the effect of significantly increasing the applicable margin rates for our senior secured term loans by 300 to 325 basis points and by 275 basis points for our senior revolving credit facility. Given the significant amount of debt outstanding under the senior credit facility, the increased interest rates will have a significant impact on our required interest payments to be made in future periods. However, we believe that we will have sufficient liquidity provided by operating cash flow to be able to satisfy the level of debt service requirements as revised by this amendment.

Based on our ability to amend the secured credit facility as discussed above and our periodic borrowings under the senior revolving credit facility during fiscal 2008 for amounts above the amounts required to fund operations in order to ensure the availability of funds under the agreement, we believe that we will be able to obtain additional funds as necessary under this arrangement during fiscal 2009 in order to support our operations.

As a result of the IPO completed April 12, 2006, approximately \$90 million of the net proceeds were used to retire the Senior Subordinated PIK Notes including accrued interest and prepayment penalties thereon, and approximately \$52 million was used to repurchase and retire \$47.5 million of the aggregate principal amount outstanding under our 2014 Notes along with accrued interest and market premiums thereon. We also retired \$68.1 million of our 2014 Notes during fiscal 2007. Since August 25, 2006, the date of the Third Amended and Restated Credit Agreement, we have repaid \$62.9 million of the outstanding balance of the term loans, including \$26.2 million of payments made in fiscal 2008.

Debt

We have incurred debt, including senior credit facilities consisting of a \$125 million senior secured revolving credit facility maturing in April 2010 and senior secured term loan facilities maturing in August 2011 and August 2012. Outstanding balances on these senior facilities were \$441.6 million at November 30, 2008. We also have an outstanding principal balance of \$273.9 million at November 30, 2008 on our 2014 Notes.

On August 25, 2006, we amended our senior secured credit agreement to provide for two senior secured term loans, one for \$300 million maturing August 25, 2011 and one for \$140 million maturing August 25, 2012. As indicated above, we amended our senior secured credit agreement in fiscal 2008 to make the financial leverage and interest coverage ratios less restrictive. The 2008 amendment also increased the applicable interest rate margins charged on the senior secured term loans and senior revolving credit facility, by 325 basis points on the \$300 million term loan, 300 basis points on the \$140 million term loan and 275 basis points on the senior revolving credit facility. In addition, this

amendment also increased the percentage of excess cash flow that is required to be used to prepay loans beginning with the 2009 fiscal year. The total amount of \$125 million available under our senior revolving credit facility was unchanged by the amendment. However, certain amendments were made to the availability of these funds through the swing-line provisions of the agreement. In connection with the 2008 amendment, we incurred a charge of \$5.4 million during the fourth fiscal quarter of 2008 for fees and expenses related to the amendment. Since August 25, 2006 we have repaid \$33.9 million of the original \$140 million outstanding on our term loan maturing August 25, 2012 and \$28.9 million of the original \$300 million outstanding on our term loan maturing August 25, 2011.

Future principal debt payments are expected to be paid out of cash flows from operations and borrowings on our revolving credit facility. As of January 2, 2009, we have \$76.5 million outstanding under our revolving credit facility.

Borrowings under the new senior secured credit facilities bear interest at our choice of the Eurodollar rate or adjusted base rate ("ABR"), in each case, plus an applicable margin of 4.50% for Eurodollar loans and 3.75% for ABR loans. As amended, beginning in fiscal 2009, we may be required to make principal prepayments that are equal to 75% of excess cash flow for the preceding fiscal year, as defined in our senior secured credit agreement, reducing to 50% if our leverage ratio is less than or equal to 4.00 to 1.00. We do not expect there to be any mandatory prepayments due in fiscal 2009.

On June 15, 2007, we entered into an interest rate swap agreement effective December 3, 2007 fixing the floating portion of the interest rate at 5.495% on \$242 million of the outstanding balance under the senior secured term loan through November 2008, declining to \$240 million from December 2008 through November 2009, and further declining to \$180 million from December 2009 through November 2010. We will select the Eurodollar rate on the hedged portion of the senior secured term loan during the term of the swap.

Additionally, we entered into three interest rate swaps for 2.3 million Euro, 2.9 million Euro, and 3.5 million Euro which fix the floating interest rate on the debt of our Europe segment at 4.92%, 4.85%, and 4.50%, respectively. The notional amounts of these contracts amortize over the life of the agreement and the agreements expire in May 2019, January 2013 and October 2013. We have not formally documented these interest rate swaps as hedges. Therefore, changes in the fair value of these interest rate swaps are recorded as a component of interest expense.

Subsequent to year-end, on December 1, 2008, the Company entered into two interest rate swap agreements effective December 4, 2008. The first of these swaps fixes the floating portion of the interest rate at 1.952% on \$20.0 million of the outstanding balance under the senior credit facility through November 4, 2009. The second of these swaps fixes the floating portion of the interest rate at 1.991% on \$107.0 million of the outstanding balance under the senior credit facility through February 4, 2010. The Company will select the Eurodollar rate on the hedged portion of the senior credit facility during the term of these swaps.

The outstanding 2014 Notes, which are publicly traded, registered securities, consist of \$273.9 million aggregate principal amount maturing June 15, 2014, bearing interest at 8.25% per annum payable semiannually in arrears on June 15 and December 15, commencing on December 15, 2004. During the second quarter of fiscal 2006, we used a portion of the proceeds from the IPO to retire approximately \$47.5 million aggregate principal amount of the 2014 Notes. During the third and fourth quarters of fiscal 2007, we retired an additional \$28.0 million and \$40.1 million, respectively, aggregate principal amount of the 2014 Notes. There were no retirements of the 2014 Notes in fiscal 2008.

At November 30, 2008 we were in compliance with the covenants contained within our senior credit agreements and indenture governing the 2014 Notes.

As part of our ongoing evaluation of our capital structure, we continually assess opportunities to reduce our debt, which opportunities may from time to time include voluntary prepayments of our senior secured term debt, or redemption or repurchase of a portion of our senior subordinated notes to the extent permitted by our debt covenants. During the fourth quarter of fiscal 2008, the Company made a voluntary prepayment on its Tranche A term loan of \$11.3 million. This prepayment was allocated to the mandatory principal payments under Tranche A due in February, May and August of 2009. In addition, our Board authorized a common stock repurchase program under which we may repurchase up to \$100 million of our Company's stock. Our ability to repurchase common stock under this program is restricted by the Company's Third Amended and Restated Credit Agreement as amended. As of November 30, 2008, we had repurchased \$16.3 million under this program, of which none was repurchased during the fourth quarter of fiscal 2008. From December 1, 2008 through January 2, 2009, there were no repurchases of shares under this program.

Our ability to make scheduled payments of principal, or to pay the interest on or to refinance our indebtedness, or to fund planned capital expenditures will depend on our future performance, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Based upon the current level of operations and our current expectations for future periods in light of the current economic environment, we believe that cash flow from operations and available cash, together with available borrowings under the senior credit agreement, will be adequate to meet the future liquidity needs during the one year following November 30, 2008. We will be required to make scheduled principal payments of approximately \$21.3 million during the next twelve months, with \$3.8 million for our senior secured term loans, \$1.9 million for our financing obligations and capital leases and the remainder for debt owed by our international subsidiaries. However, as we continually evaluate our ability to make additional prepayments as permitted under our senior credit agreements, it is possible that we will make additional voluntary prepayments on our senior debt during that time to the extent permitted by our debt covenants.

While we believe that we will have the necessary liquidity through our operating cash flow and revolving credit facility for the next year to fund our debt service requirements, capital expenditures and other operational cash requirements, we may not be able to generate sufficient cash flow from operations, realize anticipated revenue growth and operating improvements or obtain future borrowings under the senior credit agreements in an amount sufficient to enable us to do so. In addition, we rely on the revolving credit facility to provide a significant portion of our operational cash flow needs and debt service requirements. While this facility remains in place through April 2010, we expect there will be a need to refinance this debt upon its maturity. Additionally, the senior and subordinated debt mature in the following years through 2014, and we will likely be required to refinance this debt as it matures. We may not be able to affect any future refinancing of our debt on commercially reasonable terms or at all.

Dividend

During fiscal 2008, the Company paid out dividends totaling \$6.8 million.

The Company announced on April 8, 2008 that its Board of Directors voted to suspend the Company's quarterly dividend. This decision is intended to increase our financial flexibility and will enable it to better allocate its capital in order to enhance shareholder returns over time. Our senior secured credit facilities contain restrictions on our ability to pay dividends such as meeting a minimum leverage ratio. We currently do not meet this requirement. Therefore, we do not currently expect a dividend will be declared during the first fiscal quarter of 2009.

Cash Flow Analysis

The following table summarizes our changes in cash:

	Fiscal year(1)		
	2008	2007	2006
(in thousands)			
Statement of Cash Flow Data:			
Cash flows provided by (used in):			
Operating activities	\$ 53,713	\$ 94,382	\$ 58,225
Investing activities	(24,913)	(37,369)	(30,337)
Financing activities	(18,669)	(86,218)	(18,938)
Effect of exchange rate changes on cash	1,858	(1,808)	116
Change in cash and cash equivalents	11,989	(31,013)	9,066
Cash and cash equivalents:			
Beginning of period	14,607	45,620	36,554
End of period	\$ 26,596	\$ 14,607	\$ 45,620

(1)

We use a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal years ended November 30, 2008 and November 26, 2006 were 52-week years. The fiscal year ended December 2, 2007 was a 53-week year.

Year Ended November 30, 2008 Compared With Year Ended December 2, 2007

Cash Flows from Operating Activities. Our cash flow from operations decreased \$40.7 million to a \$53.7 million net source of cash for the year ended November 30, 2008, compared to a \$94.4 million net source of cash for the year ended December 2, 2007. This decrease has been primarily driven by a reduction in net income from fiscal 2007 of \$82.2 million. This decrease has been partially offset by changes in working capital driven primarily by a reduction in accounts receivable balances.

Cash Flows used in Investing Activities. Our cash flows used in investing activities decreased approximately \$12.5 million from fiscal 2007 primarily due to \$17.5 million lower capital expenditures for fiscal 2008 as compared with the prior fiscal year. The decreased capital expenditures were primarily due to the completion of our new facility in Orlando, Florida, the completion of the Mountain Top, Pennsylvania facility and the commencement of work on a second production line at the same facility and the construction of a warehouse at our production site in Italy in fiscal 2007. These expenditures were partially offset by \$5.0 million lower proceeds on sales of assets. Fiscal 2007 results included \$4.8 million received from the sale of our Orlando, Florida facility.

Cash Flows used in Financing Activities. Our cash flow used in financing activities for the year ended November 30, 2008 decreased \$67.5 million to a net use of \$18.7 million from a net use of \$86.2 million for the year ended December 2, 2007. This decrease has been driven by \$20.6 million less of dividend payments and \$4.4 million less net borrowings against our senior revolving credit facility in fiscal 2008. Further, in fiscal 2007, \$16.3 million was used to repurchase our common stock, \$68.1 million was used to retire a portion of our 2014 Notes and \$11.6 million was used for payments on our senior secured term loans.

Year Ended December 2, 2007 Compared With Year Ended November 26, 2006

Cash Flows from Operating Activities. Our cash flow from operations increased \$36.2 million to a \$94.4 million net source of cash for the year ended December 2, 2007, compared to a \$58.2 million net source of cash for the year ended November 26, 2006. Contributing to this increase was the inclusion of

approximately \$32.1 million of expenses in net income and interest payments associated with the IPO and related debt extinguishments in the prior year, with the remaining increase primarily the result of changes in working capital and timing of various vendor payments.

Cash Flows from Investing Activities. Our cash flows used in investing activities increased approximately \$7.0 million from fiscal 2006 primarily due to \$11.6 million higher capital expenditures for fiscal 2007 as compared with the prior fiscal year. The increased capital expenditures were primarily due to the completion of our new facility in Orlando, Florida, the completion of the Mountain Top, Pennsylvania facility and the commencement of work on a second production line at the same facility and the construction of a warehouse at our production site in Italy. These expenditures were partially offset by \$4.5 million higher proceeds on sales of assets, including \$4.8 million received from the sale of our Orlando, Florida facility.

Cash Flows from Financing Activities. Our cash flow used in financing activities for the year ended December 2, 2007 increased \$67.3 million to a net use of \$86.2 million from a net use of \$18.9 million for the year ended November 26, 2006. This increase has been primarily driven by \$16.3 million used to repurchase our common stock, the retirement of \$68.1 million of our 2014 Notes and \$11.6 million of payments on our senior secured term loans in fiscal 2007. These uses have been partially offset by an increase in the net borrowings against our outstanding senior revolving credit facility of \$32.3 million in fiscal 2007. In fiscal 2006, we received \$295.3 million of IPO proceeds which were used to make a \$125 million dividend payment and to retire \$139.3 million of debt.

Debt Covenants

Our long term obligations contain various financial tests and covenants. The senior secured credit facilities require us to meet a minimum interest coverage ratio and a maximum leverage ratio. The indenture governing the 2014 Notes also requires us to meet a fixed charge coverage ratio in order to incur additional indebtedness, subject to certain exceptions. We are currently in compliance with all debt covenants. The specific covenants and related definitions can be found in the applicable debt agreements, each of which we have previously filed with the Securities and Exchange Commission. As of November 30, 2008 our calculated maximum leverage ratio was 4.69 times compared with a requirement of 5.85 times and our minimum interest coverage ratio was 2.87 times compared with a requirement of 2.00 times.

Certain covenants contained in the senior secured credit facilities and 2014 Notes are based on what we refer to herein as "Adjusted EBITDA." In those agreements, EBITDA is defined as net income plus interest, taxes, depreciation and amortization and Adjusted EBITDA is defined as EBITDA further adjusted to exclude unusual items and other adjustments permitted in calculating covenant compliance as discussed above. Adjusted EBITDA is presented herein as it is a material component of these covenants. For instance, the indenture governing the 2014 Notes and the agreement governing Sealy Mattress Company's senior secured credit facilities each contain financial covenant ratios, specifically leverage and interest coverage ratios, that are calculated by reference to Adjusted EBITDA. Non-compliance with the financial ratio maintenance covenants contained in Sealy Mattress Company's senior secured credit facilities could result in the requirement to immediately repay all amounts outstanding under such facilities, while non-compliance with the debt incurrence ratios contained in the indenture governing the 2014 Notes would prohibit Sealy Mattress Company and its subsidiaries from being able to incur additional indebtedness other than pursuant to specified exceptions. In addition, under the restricted payment covenants contained in the indenture governing the 2014 Notes, the ability of Sealy Mattress Company to pay dividends is restricted by formula based on the amount of Adjusted EBITDA. While the determination of "unusual items" is subject to interpretation and requires judgment, we believe the adjustments listed below are in accordance with the covenants discussed above and are pursuant to the terms of the debt agreement or approval of the debtors.

EBITDA and Adjusted EBITDA are not recognized terms under GAAP and do not purport to be alternatives to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Additionally, they are not intended to be measures of free cash flow for management's discretionary use, as they do not consider certain cash requirements such as interest payments, tax payments and debt service requirements. Because not all companies use identical calculations, these presentations may not be comparable to other similarly titled measures of other companies.

The following table sets forth a reconciliation of net loss to EBITDA and EBITDA to Adjusted EBITDA for the year ended November 30, 2008 (in thousands):

Net loss	\$ (2,867)
Interest expense	60,464
Income taxes	21,931
Depreciation and amortization	33,954
	<u>113,482</u>
EBITDA	113,482
Unusual and nonrecurring losses:	
Goodwill impairment	27,475
Debt refinancing costs	5,378
Executive severance	3,470
Non-cash compensation	3,375
Restructuring related costs	3,402
Non-executive severance	2,549
Other (various)(a)	7,795
Adjusted EBITDA	<u>\$ 166,926</u>

(a) Consists of various immaterial adjustments.

The following table reconciles EBITDA to cash flows from operations for the year ended November 30, 2008 (in thousands):

EBITDA	\$ 113,482
Adjustments to EBITDA to arrive at cash flow from operations:	
Interest expense	(60,464)
Income taxes	(21,931)
Non-cash charges against (credits to) net income:	
Deferred income taxes	8,317
Non-cash interest expense	2,395
Other, net	27,855
Changes in operating assets & liabilities	(15,941)
Cash flow from operations	<u>\$ 53,713</u>

As of and during the fiscal years ended November 30, 2008, December 2, 2007 and November 26, 2006, we were in compliance with the covenants contained within our debt instruments.

Off-Balance Sheet Arrangements

We occupy premises and utilize equipment under operating leases that expire at various dates through 2023. In accordance with generally accepted accounting principles, the obligations under those leases are not recorded on our balance sheet. Many of these leases provide for payment of certain expenses and contain renewal and purchase options. During the fiscal years ended November 30, 2008,

December 2, 2007 and November 26, 2006, we recognized lease expenses of \$21.6 million, \$20.7 million and \$19.6 million, respectively.

We are involved in a joint venture to develop markets for *Sealy* branded products in Asia. The joint venture is not considered to be a variable interest entity and is therefore not consolidated for financial statement purposes. We account for our interest in the joint venture under the equity method, and our net investment of \$3.1 million is recorded as a component of "Debt issuance costs, net", and other assets within the Consolidated Balance Sheet at November 30, 2008. We believe that any possible commitments arising from this joint venture will not be significant to our consolidated financial position or results of operations.

Contractual Obligations and Commercial Commitments

As previously discussed, our debt at November 30, 2008 consists of \$64.4 million outstanding under a \$125 million senior secured revolving credit facility maturing in 2010, \$270.0 million outstanding under a senior secured term loan facility maturing in 2011, \$107.2 million outstanding under a senior secured term loan facility maturing in 2012, \$273.9 million outstanding aggregate principal amount of senior subordinated notes due 2014, \$42.3 million due on our financing obligations and an additional \$25.5 million of other borrowings, most of which are owed by our international subsidiaries.

We engage in various hedging activities in order to mitigate the risk of variability in future cash flows resulting from floating interest rates on our debt and projected foreign currency purchase requirements. Accordingly, we have entered into contractual arrangements for interest rate swaps and forward purchases of foreign currency. The related assets and liabilities associated with the fair value of such derivative instruments are recorded on our balance sheet. Changes in the fair value of these derivatives are recorded in our income statement, except for those associated with those agreements which have been designated as cash flow hedges for accounting purposes.

Significant judgment is required in evaluating the Company's federal, state and foreign tax positions and in the determination of its tax provision. Despite the Company's belief that its liability for unrecognized tax benefits is adequate, it is often difficult to predict the final outcome or the timing of the resolution of any particular tax matter. The Company may adjust these liabilities as relevant circumstances evolve, such as guidance from the relevant tax authority, or resolution of issues in the courts. These adjustments are recognized as a component of income tax expense entirely in the period in which they are identified. While the Company is currently undergoing examinations of certain of its corporate income tax returns by tax authorities, no issues related to these reserves have been presented to the Company and the Company has not been informed that such audits will result in an assessment or payment of taxes related to these positions during the one year period following November 30, 2008.

We adopted FIN 48, "Accounting for Uncertainty in Income Taxes", effective December 3, 2007. As of the date of the adoption, our reserve for uncertain tax positions (including penalties and interest) was \$10.5 million. At November 30, 2008, the entire reserve for uncertain tax positions of \$22.6 million (including penalties and interest) of which \$8.8 million is classified as a noncurrent asset and \$31.4 million is classified as a noncurrent liability. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of the effective settlement of tax positions. As such, the unrecognized tax benefit liabilities are not included in the table below.

Our contractual obligations and other commercial commitments as of November 30, 2008 are summarized below (in thousands):

Contractual Obligations	2009	2010	2011	2012	2013	After 2014	Total Obligations
Principal maturities of long-term debt	\$ 21,243	\$ 143,012	\$ 194,557	\$ 110,545	\$ 3,278	\$ 310,770	\$ 783,405
Projected interest on long-term debt(1)	59,371	58,442	47,739	33,526	24,990	25,262	249,330
Projected cash flows on derivatives(2)	7,865	6,594	1,343	(61)	(41)	(103)	15,597
Operating leases(3)	13,571	12,125	9,658	6,898	4,536	15,759	62,547
Obligations under license agreements(4)	3,810	953	—	—	—	—	4,763
Purchase commitments related to capital expenditures(5)	929	—	—	—	—	—	929
Total	\$ 106,789	\$ 221,126	\$ 253,297	\$ 150,908	\$ 32,763	\$ 351,688	\$ 1,116,571

Other Commercial Commitments	2009	2010	2011	2012	2013	After 2014	Total Commitments
Standby Letters of Credit(6)	\$ 15,863	—	—	—	—	—	\$ 15,863

- (1) \$214.1 million of our outstanding debt at November 30, 2008 is subject to variable interest rates. Interest payments are projected based on rates in effect at November 30, 2008 assuming no variable rate fluctuations going forward. After giving effect to the interest rate swap agreements that were entered into on December 1, 2008 which converted another \$127.0 million of variable rate debt to a fixed interest rate, an increase in the interest rates applicable to the unhedged portion of our variable rate debt by 1% would result in approximately \$0.9 million in additional annual cash interest expense.
- (2) Net cash payments on our hedging instruments consist of the projected net settlements of our interest rate swap as of November 30, 2008 based on the projected interest rates used to value the swap on that date. In addition, we entered into two additional interest rate swaps on December 1, 2008. See Note 24 to the Consolidated Financial Statements.
- (3) Obligations under operating leases include only projected payments under current lease terms, excluding renewal options and assuming no exercise of any purchase options.
- (4) Amounts represent minimum guarantees owed under license agreements.
- (5) We have made firm purchase commitments of approximately \$0.9 million as of November 30, 2008 related to the purchase of equipment related to a new product line.
- (6) We issue letters of credit in the ordinary course of business primarily to back our various obligations under workers compensation and other insurance programs, environmental liabilities, and open positions on certain of our derivative instruments. These obligations will renew automatically on an annual basis unless cancelled per our instructions.

As discussed in Note 16 to our Consolidated Financial Statements included in Item 8, we have a \$9.2 million long term obligation arising from underfunded pension plans. Future minimum pension funding requirements are not included in the schedule above as they are not available for all periods presented. During fiscal 2009, we estimate that we will make approximately \$1.2 million in contributions to the plans. In fiscal 2008, we contributed \$2.2 million into the plans. The increase in the

funding requirements between years has been driven, in part, by the underperformance of the plan assets during fiscal 2008 due to the slowdown of the overall global economy.

Only agreements to purchase goods or services with fixed or minimum obligations are included in the schedule above. It does not include normal purchases which are made in the ordinary course of business.

Foreign Operations and Export Sales

We operate three manufacturing and distribution center facilities in Canada, and one each in Mexico, Argentina, Uruguay and Brazil. In 2000, we formed a joint venture with our Australian licensee to import, manufacture, distribute and sell *Sealy* branded products in South East Asia. We operate a South Korean sales office and use a contract manufacturer to help service the South Korean market. On December 1, 2008, a fifty percent interest in our operations in South Korea was sold for \$1.4 million to our Australian licensee and these operations became part of the joint venture. (See Note 24 to the Consolidated Financial Statements in Item 8). We also export products directly into many small international markets, and have license agreements in Thailand, Japan, the United Kingdom, Spain, Australia, New Zealand, South Africa, Israel, Jamaica, Saudi Arabia, the Bahamas and the Dominican Republic. The results of these export operations are considered a component of our Americas segment.

In addition, we own Sapsa Bedding S.A.S., a leading European manufacturer of latex bedding products in Europe, with headquarters in Italy and manufacturing operations in France and Italy and which are components of our Europe segment.

Impact of Recently Issued Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FAS 109, "Accounting for Income Taxes." This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. We adopted the provisions of this interpretation effective December 3, 2007. As a result of the adoption of this interpretation, we recorded an increase of approximately \$10.5 million to the liability for uncertain tax positions in the Consolidated Balance Sheets for unrecognized tax benefits, which was accounted for as a cumulative effect adjustment to the December 3, 2007, balance of accumulated deficit. See Note 15 to our Consolidated Financial Statements.

In September 2006, the FASB issued FAS 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosure about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157", which provides a one year deferral of the effective date of FAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In accordance with this interpretation, we have only adopted the provisions of FAS 157 with respect to its financial assets and liabilities that are measured at fair value within the financial statements as of December 3, 2007. The provisions of FAS 157 have not been applied to non-financial assets and non-financial liabilities. The major categories of assets and liabilities that are measured at fair value, for which we have not applied the provisions of FAS 157 are as follows: asset retirement obligations, reporting units measured at fair value in the first step of a goodwill impairment test under FAS 142, long-lived assets measured at fair value for an impairment assessment under FAS 146.

In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active", which clarifies the application of SFAS 157 as it relates to the valuation of financial assets in a market that is not active for those financial assets. This FSP is effective immediately and includes those periods for which financial statements have not been issued. We currently do not have any financial assets that are valued using inactive markets, and as such are not impacted by the issuance of this FSP.

In February 2007, the FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment to FASB Statement No. 115," which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. We adopted this statement as of December 3, 2007 and have elected not to apply the fair value option to any of our financial instruments.

In June 2007, the Emerging Issues Task Force ("EITF") issued EITF 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities," which provides guidance on the accounting for certain nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities. This issue is effective prospectively for fiscal years beginning after December 15, 2007, or fiscal 2009 for us. We are still assessing the potential impact of adoption.

In December 2007, the FASB issued FAS 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51". This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. This statement will be effective for us beginning in fiscal 2010. We are still assessing the potential impact of adoption.

In December 2007, the FASB issued FAS 141(R), "Business Combinations—a replacement of FASB Statement No. 141", which significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement is effective prospectively, except for certain retrospective adjustments to deferred tax balances, for fiscal years beginning after December 15, 2008. This statement will be effective for us beginning in fiscal 2010. We are still assessing the potential impact of adoption.

In March 2008, the FASB issued FAS 161, "Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133", which amends and expands the disclosure requirements of FAS 133 to require qualitative disclosure about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. In September 2008, the FASB issued FASB Staff Position No. FAS 133-1 and FIN 45-4 which, among other things, clarified the effective date of FAS 161 to be effective for fiscal years and interim periods beginning after November 15, 2008. Based on this clarification, FAS 161 will be effective for us beginning in the first quarter fiscal 2009. The adoption of this statement will increase the disclosures in the financial statements related to derivative instruments held by us.

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Lives of Intangible Assets", which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of an intangible asset. This interpretation is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim

periods within those years. We will adopt this interpretation as of the beginning of fiscal 2010 and are still assessing the potential impact of adoption.

In June 2008, the FASB issued FASB Staff Position FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities", which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. This interpretation is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. We will adopt this interpretation as of the beginning of fiscal 2010 and are still assessing the potential impact of adoption.

In November 2008, the Emerging Issues Task Force issued EITF Issue No. 08-06, "Equity Method Investment Considerations", which clarifies the accounting for certain transactions involving equity method investments. This interpretation is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 and interim periods within those years. We will adopt this issue as of the beginning of fiscal 2010 and are still assessing the potential impact of adoption.

In December 2008, the FASB issued FASB Staff Position FSP 132(R)-1, "Employers Disclosures about Postretirement Benefit Plan Assets", which provides additional guidance on an employers' disclosures about plan assets of a defined benefit pension or other postretirement plan. This interpretation is effective for financial statements issued for fiscal years ending after December 15, 2009. We will adopt this interpretation in fiscal 2010. The adoption of this interpretation will increase the disclosures in the financial statements related to the assets of our defined benefit pension plans.

General Business Risk

Our customers include furniture stores, specialty sleep shops, department stores, membership warehouse clubs, hospitality customers and other stores. In the future, these customers may consolidate, undergo restructurings or reorganizations, or realign their affiliations, any of which could decrease the number of locations that carry our products. These customers are also subject to changes in consumer spending and the overall state of the economy, both domestically and internationally. As we have seen in fiscal 2008, our business, financial condition and results of operations may be affected by various economic factors. Unfavorable economic conditions such as the global economic downturn we are currently experiencing has made it more difficult for us to maintain and continue our revenue growth. In an economic recession or under other adverse economic conditions, customers and vendors may be more likely to be unable to meet contractual terms or their payment obligations. Any of these factors could have a material adverse effect on our business, financial condition or results of operations.

Fiscal Year

We use a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal year ended December 2, 2007 was a 53-week year. The fiscal years ended November 30, 2008 and November 26, 2006 were 52-week years.

Forward Looking Statements

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995. When used in this Annual Report on Form 10-K, the words "believes," "anticipates," "expects," "intends," "projects" and similar expressions are used to identify forward-looking statements within the meaning of Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to future financial and operation results. Any forward-looking statements contained in this report represent our management's current expectations, based on present information and current assumptions, and are thus prospective and subject to risks and uncertainties which could cause actual results to differ materially from those expressed in such forward-looking statements. Actual results could differ

materially from those anticipated or projected due to a number of factors. These factors include, but are not limited to:

- the level of competition in the bedding industry;
- legal and regulatory requirements;
- the success of new products;
- our relationships with our major suppliers;
- fluctuations in costs of raw materials;
- our relationship with significant customers and licensees;
- our labor relations;
- departure of key personnel;
- encroachments on our intellectual property;
- product liability claims;
- the timing, cost and success of opening new manufacturing facilities;
- our level of indebtedness;
- interest rate risks;
- access to financial credit by our customers, vendors or us;
- future acquisitions;
- an increase in return rates; and
- other risks and factors identified from time to time in the Company's reports filed with the Securities and Exchange Commission, or the SEC.

All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this Annual Report on Form 10-K and are expressly qualified in their entirety by the cautionary statements included in this Annual Report on Form 10-K. Except as may be required by law, we undertake no obligation to publicly update or revise forward-looking statements which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

Foreign Currency Exposures

Our earnings are affected by fluctuations in the value of our subsidiaries' functional currency as compared to the currencies of our foreign denominated purchases. Foreign currency forward contracts are used to hedge against the earnings effects of such fluctuations. The result of a uniform 10% change in the value of the U.S. dollar relative to currencies of countries in which we manufacture or sell our products would result in a change of approximately \$1.7 million in our earnings. This calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar.

To protect against the reduction in value of forecasted foreign currency cash flows resulting from purchases in a foreign currency, we have instituted a forecasted cash flow hedging program. We hedge portions of our purchases denominated in foreign currencies and royalty payments to third parties with forward contracts. At November 30, 2008, we had five forward foreign currency contracts outstanding to purchase a total of 2.5 million Euros with expiration dates ranging from December 31, 2008 through

December 31, 2009. At November 30, 2008, the fair value of these contracts was a liability of an insignificant amount. The changes in fair value of the foreign currency hedges are included in net income, except for those contracts that have been designated as hedges for accounting purposes. For contracts designated as hedges for accounting purposes, the changes in fair value related to the effective portion of the hedge are recognized as a component of comprehensive income.

Interest Rate Risk

We are exposed to interest rate risk on our variable rate debt. To manage this risk, we enter into interest rate swap agreements to convert certain variable rate debt to fixed rate debt. As of November 30, 2008, we had an outstanding interest rate swap agreement effective December 3, 2007 that fixes the floating portion of the interest rate at 5.495% on \$242 million of the outstanding balance under the senior secured term loan through November 2008, declining to \$240 million from December 2008 through November 2009, and further declining to \$180 million from December 2009 through November 2010. The fair value of this swap instrument was a liability of \$15.9 million at November 30, 2008.

Additionally, we entered into three interest rate swaps for 2.3 million Euro, 2.9 million Euro, and 3.5 million Euro which fix the floating interest rate on the debt of our Europe segment at 4.92%, 4.85%, and 4.50%, respectively. The notional amounts of these contracts amortize over the life of the agreement and the agreements expire in May 2019, January 2013 and October 2013. We have not formally documented these interest rate swaps as hedges. Therefore, changes in the fair value of these interest rate swaps are recorded as a component of interest expense. The fair value of these swap instruments was an asset of \$0.4 million at November 30, 2008.

Subsequent to year-end, on December 1, 2008, the Company entered into two interest rate swap agreements effective December 4, 2008. The first of these swaps fixes the floating portion of the interest rate at 1.952% on \$20.0 million of the outstanding balance under the senior credit facility through November 4, 2009. The second of these swaps fixes the floating portion of the interest rate at 1.991% on \$107.0 million of the outstanding balance under the senior credit facility through February 4, 2010.

A 10% increase or decrease in market interest rates that affect our interest rate derivative instrument would not have a material impact on our earnings during the next fiscal year.

Based on the unhedged portion of our variable rate debt outstanding at November 30, 2008, a 12.5 basis point increase or decrease in variable interest rates would have an approximately \$0.3 million dollar impact on our annual interest expense. This is before giving effect to the two new interest rate swap agreements that were entered into on December 1, 2008 for a combined notional amount of \$127.0 million.

Commodity Price Risks

The cost of our steel innerspring, polyurethane foam, polyester and polyethylene component parts are impacted by the unprecedented volatility in the price of steel and petroleum. We expect the cost of these components to decrease at least initially in fiscal 2009 due to an expected decline in related commodity prices. During fiscal 2008, we entered into commodity-based physical contracts to buy natural gas at agreed-upon fixed prices. These contracts were entered into in the normal course of business. We do not engage in commodity hedging programs.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Sealy Corporation
Trinity, North Carolina

We have audited the accompanying consolidated balance sheets of Sealy Corporation and subsidiaries (the "Company") as of November 30, 2008 and December 2, 2007, and related consolidated statements of operations, stockholders' deficit, and cash flows for each of the three fiscal years in the period ended November 30, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Sealy Corporation and subsidiaries as of November 30, 2008 and December 2, 2007, and the results of their operations and their cash flows for each of the three fiscal years in the period ended November 30, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects the information set forth therein.

As discussed in Notes 1, 8, 15 and 16 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans", in fiscal 2007 and the Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109", effective December 3, 2007. Also, as discussed in Note 1, the fiscal year ended December 2, 2007 included 53 weeks. The fiscal years ended November 30, 2008 and November 26, 2006 included 52 weeks.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of November 30, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 13, 2009 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Charlotte, North Carolina
January 15, 2009

SEALY CORPORATION

Consolidated Balance Sheets

(in thousands, except per share amounts)

	November 30, 2008	December 2, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 26,596	\$ 14,607
Accounts receivable (net of allowance for doubtful accounts, discounts and returns, 2008—\$24,910; 2007—\$26,420)	156,583	208,821
Inventories, net	64,634	73,682
Prepaid expenses and other current assets	30,969	26,497
Deferred income taxes	16,775	20,087
	<u>295,557</u>	<u>343,694</u>
Property, plant and equipment—at cost:		
Land	12,489	13,065
Buildings and improvements	144,881	146,137
Machinery and equipment	287,817	270,905
Construction in progress	4,121	12,199
	<u>449,308</u>	<u>442,306</u>
Less accumulated depreciation	(218,560)	(198,434)
	<u>230,748</u>	<u>243,872</u>
Other assets:		
Goodwill	357,149	395,460
Other intangibles—net of accumulated amortization (2008—\$13,434; 2007—\$11,612)	4,945	8,866
Deferred income taxes	3,392	—
Debt issuance costs, net, and other assets	29,083	33,187
	<u>394,569</u>	<u>437,513</u>
Total Assets	<u>\$ 920,874</u>	<u>\$ 1,025,079</u>

See accompanying notes to consolidated financial statements.

SEALY CORPORATION

Consolidated Balance Sheets (Continued)

(in thousands, except per share amounts)

	November 30, 2008	December 2, 2007
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Current portion-long term obligations	\$ 21,243	\$ 36,433
Accounts payable	97,084	135,352
Accrued expenses:		
Customer incentives and advertising	34,542	47,754
Compensation	24,797	32,422
Interest	16,432	16,526
Other	44,363	53,398
	<u>238,461</u>	<u>321,885</u>
Long term obligations, net of current portion	762,162	757,322
Other noncurrent liabilities	71,257	50,814
Deferred income taxes	4,962	8,295
Commitments and contingencies	—	—
Common stock and options subject to redemption	8,856	16,156
Stockholders' deficit:		
Preferred stock, \$0.01 par value; Authorized 50,000 shares; Issued, none	—	—
Common stock, \$0.01 par value; Authorized 200,000 shares; Issued and outstanding: 2008—91,800; 2007—90,814 (including shares classified above as subject to redemption: 2008—282; 2007—401)	917	902
Additional paid-in capital	668,547	654,626
Accumulated deficit	(814,298)	(794,160)
Accumulated other comprehensive (loss) income	(19,990)	9,239
	<u>(164,824)</u>	<u>(129,393)</u>
Total Liabilities and Stockholders' Deficit	\$ 920,874	\$ 1,025,079

See accompanying notes to consolidated financial statements.

SEALY CORPORATION

Consolidated Statements of Operations

(in thousands, except per share amounts)

	Year Ended		
	November 30, 2008	December 2, 2007	November 26, 2006
Net sales	\$ 1,498,023	\$ 1,702,065	\$ 1,582,843
Cost of goods sold	913,982	992,455	874,927
Gross profit	584,041	709,610	707,916
Selling, general and administrative expenses (including provisions for bad debts of \$10,279, \$6,620 and \$2,705, respectively)	482,566	545,608	499,614
Expenses associated with initial public offering of common stock	—	—	28,510
Goodwill impairment loss	27,475	—	—
Amortization of intangibles	3,692	3,356	5,707
Restructuring expenses	3,126	—	—
Royalty income, net of royalty expense	(17,327)	(18,562)	(18,855)
Income from operations	84,509	179,208	192,940
Interest expense	60,464	63,976	71,961
Debt extinguishment and refinancing expenses	5,378	1,222	9,899
Other income, net	(397)	(421)	(750)
Income before income tax expense	19,064	114,431	111,830
Income tax expense	21,931	35,058	37,576
Income before cumulative effect of change in accounting principle	(2,867)	79,373	74,254
Cumulative effect of the adoption of FASB Interpretation No. 47, net of related tax benefit of \$191	—	—	287
Net income (loss)	\$ (2,867)	\$ 79,373	\$ 73,967
Earnings (losses) per common share—Basic			
Income before cumulative effect of change in accounting principle	\$ (0.03)	\$ 0.87	\$ 0.89
Cumulative effect of a change in accounting principle	—	—	—
Earnings (losses) per common share—Basic	\$ (0.03)	\$ 0.87	\$ 0.89
Earnings (losses) per common share—Diluted			
Income before cumulative effect of change in accounting principle	\$ (0.03)	\$ 0.82	\$ 0.83
Cumulative effect of a change in accounting principle	—	—	—
Earnings (losses) per common share—Diluted	\$ (0.03)	\$ 0.82	\$ 0.83
Weighted average number of common shares outstanding:			
Basic	91,231	91,299	83,622
Diluted	91,231	96,337	89,558

See accompanying notes to consolidated financial statements.

SEALY CORPORATION

Consolidated Statements of Stockholders' Deficit

(in thousands, except per share amounts)

	Comprehensive Income (Loss)	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)		Total
		Shares	Amount					
Balance at November 27, 2005	\$ 65,322	70,480	\$ 702	\$ 365,900	\$ (781,463)	\$ 2,638		\$(412,223)
Net income	73,967				73,967			73,967
Foreign currency translation adjustment	5,489					5,489		5,489
Excess of additional pension liability over unrecognized prior service cost, net of tax of \$66	37					37		37
Change in fair value of cash flow hedge, net of tax of \$246	(247)					(247)		(247)
Amortization of dedesignated cash flow hedge, net of tax of \$99	(124)					(124)		(124)
Initial public offering (IPO):								
Proceeds from IPO, net of underwriting discount of \$20,800		20,000	200	299,000				299,200
Direct costs of IPO				(3,852)				(3,852)
Share-based compensation:								
Conversion of options to shares in connection with the IPO		192	2	348				350
Compensation associated with stock option grants				1,655				1,655
Directors' deferred stock compensation				464				464
Cash dividend					(138,648)			(138,648)
Exercise of stock options		311	3	(2,730)				(2,727)
Excess tax benefit on options exercised				2,431				2,431
Adjustment of temporary equity subject to redemption			(3)	1,393				1,390
Balance at November 26, 2006	\$ 79,122	90,983	\$ 904	\$ 664,609	\$ (846,144)	\$ 7,793		\$(172,838)
Net income	79,373				79,373			79,373
Foreign currency translation adjustment	11,183					11,183		11,183
Excess of additional pension liability over unrecognized prior service cost, net of tax of \$568	(1,160)					(1,160)		(1,160)
Adjustment to initially adopt FASB Statement 158, net of income taxes of \$699						(1,028)		(1,028)
Change in fair value of cash flow hedge, net of tax of \$4,667	(7,549)					(7,549)		(7,549)
Share-based compensation:								
Compensation associated with stock option grants				2,124				2,124
Directors' deferred stock compensation				281				281
Cash dividend					(27,389)			(27,389)
Repurchase of common stock		(1,057)	(11)	(16,242)				(16,253)
Exercise of stock options		888	9	(6,888)				(6,879)
Excess tax benefit on options exercised				6,585				6,585
Adjustment of temporary equity subject to redemption				4,107				4,107
Other				50				50
Balance at December 2, 2007	\$ 81,847	90,814	\$ 902	\$ 654,626	\$ (794,160)	\$ 9,239		\$(129,393)
Net loss	(2,867)				(2,867)			(2,867)
Foreign currency translation adjustment	(25,047)					(25,047)		(25,047)
Adjustment to defined benefit plan liability, net of tax of \$1,045	(1,644)					(1,644)		(1,644)
Change in fair value of cash flow hedge, net of tax of \$1,559	(2,538)					(2,538)		(2,538)
Cumulative effect of a change in accounting principle—adoption of FIN 48					(10,460)			(10,460)
Share-based compensation:								
Compensation associated with stock option grants				2,981				2,981
Directors' deferred stock compensation				26				26
Current period expense from restricted stock awards				222				222
Cash dividend					(6,811)			(6,811)
Exercise of stock options		986	14	(882)				(868)
Excess tax benefit on options exercised				407				407
Expiration of retiree put liability				2,372				2,372
Adjustment of common stock and options subject to redemption			1	8,795				8,796
Balance at November 30, 2008	\$ (32,096)	91,800	\$ 917	\$ 668,547	\$ (814,298)	\$ (19,990)		\$(164,824)

See accompanying notes to consolidated financial statements.

SEALY CORPORATION

Consolidated Statements of Cash Flow

(in thousands)

	Year Ended		
	November 30, 2008	December 2, 2007	November 26, 2006
Cash flows from operating activities:			
Net income (loss)	\$ (2,867)	\$ 79,373	\$ 73,967
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	33,954	30,493	30,185
Deferred income taxes	8,317	(5,207)	2,037
Goodwill and asset impairment charges	28,348	—	—
Non-cash interest expense:			
Senior Subordinated PIK Notes	—	—	3,348
Amortization of debt issuance costs and other	2,395	(469)	1,511
Share-based compensation	3,392	2,891	2,658
Excess tax benefits from share-based payment arrangements	(406)	(6,585)	—
Loss (gain) on sale of assets	625	(1,695)	478
Write-off of debt issuance costs related to debt extinguishments	—	1,770	6,302
Cumulative effect of accounting change	—	—	478
Other, net	(4,104)	5,980	(13,914)
Changes in operating assets and liabilities:			
Accounts receivable	37,566	(5,285)	(15,133)
Inventories	5,844	(5,456)	(3,297)
Prepaid expenses and other current assets	(3,035)	(2,251)	(5,557)
Accounts payable	(29,922)	13,243	(6,088)
Accrued expenses	(27,469)	(8,597)	(6,570)
Other liabilities	1,075	(3,823)	(12,180)
Net cash provided by operating activities	53,713	94,382	58,225
Cash flows from investing activities:			
Purchase of property, plant and equipment	(24,975)	(42,434)	(30,872)
Proceeds from sale of property, plant and equipment	62	5,065	535
Net cash used in investing activities	(24,913)	(37,369)	(30,337)
Cash flows from financing activities:			
Proceeds from initial public offering of common stock, net of underwriting discount and other direct costs of \$24,489	—	—	295,348
Cash dividends	(6,811)	(27,389)	(138,648)
Proceeds from issuance of long-term obligations	9,305	—	—
Repayments of long-term obligations, including discounts taken of \$460 in 2007 and premiums paid of \$2,703 in 2006	(44,455)	(79,202)	(611,614)
Borrowings under new credit facility	—	—	440,000
Borrowings under revolving credit facilities	283,527	233,990	172,181
Repayments under revolving credit facilities	(260,617)	(206,643)	(177,155)
Repurchase of common stock	—	(16,253)	—
Exercise of employee stock options, including related excess tax benefits	482	7,166	2,559
Debt issuance costs	(100)	—	—
Other	—	2,113	(1,609)
Net cash used in financing activities	(18,669)	(86,218)	(18,938)
Effect of exchange rate changes on cash	1,858	(1,808)	116
Change in cash and cash equivalents	11,989	(31,013)	9,066
Cash and cash equivalents:			
Beginning of period	14,607	45,620	36,554
End of period	\$ 26,596	\$ 14,607	\$ 45,620
Supplemental disclosures:			
Taxes paid (net of tax refunds of \$159, \$94 and \$233 in fiscal 2008, 2007 and 2006, respectively)	\$ 22,882	\$ 39,944	\$ 42,430
Interest paid	\$ 58,164	\$ 62,097	\$ 68,101

See accompanying notes to consolidated financial statements.

SEALY CORPORATION

Notes To Consolidated Financial Statements

Note 1: *Basis of Presentation and Significant Accounting Policies*

Business

Sealy Corporation and its subsidiaries (the "Company") is engaged in the consumer products business and manufactures, distributes and sells conventional bedding products including mattresses and box springs, as well as specialty bedding products which include latex and visco-elastic mattresses. The Company's products are manufactured in a number of countries in North and South America and Europe. Substantially all of the Company's trade accounts receivables are from retail customers.

Basis of Presentation

On April 6, 2004, the Company completed a merger with affiliates of Kohlberg Kravis Roberts & Co. L.P. ("KKR") whereby KKR acquired approximately 92% of the Company's capital stock. Certain of the Company's previous stockholders, including affiliates of Bain Capital, LLC and others, retained an 8% interest in the Company's stock. The merger was accounted for as a recapitalization. Subsequent to the recapitalization, the Company contributed all of its 100% interest in Sealy Mattress Company to a newly formed subsidiary holding company, Sealy Mattress Corporation, which also replaced the Company as the parent guarantor of the 8.25% Senior Subordinated Notes due 2014 (the "2014 Notes") issued by Sealy Mattress Company.

All stock share amounts presented in the Consolidated Financial Statements and in the notes thereto have been restated to reflect a 0.7595 to 1 reverse stock split, which became effective on March 23, 2006.

On April 12, 2006, the Company completed an initial public offering ("IPO") of its common stock, raising \$299.2 million of net proceeds after deducting the underwriting discount. See Note 2 for further details on the sources and uses of cash from the IPO. Effective May 25, 2006, Sealy Corporation was named a guarantor of the 2014 Notes. At November 30, 2008, KKR controlled approximately 51% of the issued and outstanding common stock of the Company.

Significant accounting policies used in the preparation of the Consolidated Financial Statements are summarized below.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its 100%-owned subsidiary companies. Intercompany transactions are eliminated. The equity method of accounting is used for joint ventures and investments in associated companies over which the Company has significant influence, but does not have effective control and consolidation is not otherwise required under FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities an interpretation of ARB No. 51." ("FIN 46(R)") Significant influence is generally deemed to exist when the Company has an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's Board of Directors, voting rights and the impact of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate. The Company's equity in the net income and losses of these investments is reported in other income, net in the accompanying Consolidated Statements of Operations. Also, based on triggering events, the Company assesses whether it has any primary beneficial interests in any variable interest entity ("VIE") which would require consolidation of such entity in accordance with FIN 46(R).

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

At November 30, 2008, the Company is not a beneficiary in a VIE and does not have a significant variable interest in any variable interest entity for which it is not the primary beneficiary.

Fiscal Year

The Company uses a 52-53 week fiscal year ending on the closest Sunday to November 30, but no later than December 2. The fiscal year ended December 2, 2007 was a 53-week year. The fiscal years ended November 30, 2008 and November 26, 2006 were 52-week years. The net sales and gross profit attributable to the 53rd week in fiscal 2007 was \$32.3 million and \$13.1 million, respectively.

Recently Issued Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FAS 109, "Accounting for Income Taxes." This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted the provisions of this interpretation effective December 3, 2007. As a result of the adoption of this interpretation, the Company recorded an increase of approximately \$10.5 million to the liability for uncertain tax positions in the Consolidated Balance Sheets for unrecognized tax benefits, which was accounted for as a cumulative effect adjustment to the December 3, 2007 balance of accumulated deficit. See Note 15.

In September 2006, the FASB issued FAS 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosure about fair value measurements. In February 2008, the FASB issued FASB Staff Position No. FAS 157-b, "Effective Date of FASB Statement No. 157", which provides a one year deferral of the effective date of FAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. In accordance with this interpretation, the Company has only adopted the provisions of FAS 157 with respect to its financial assets and liabilities that are measured at fair value within the financial statements as of December 3, 2007. The provisions of FAS 157 have not been applied to non-financial assets and non-financial liabilities. The major categories of assets and liabilities that are measured at fair value, for which the Company has not applied the provisions of FAS 157 are as follows: asset retirement obligations, reporting units measured at fair value in the first step of a goodwill impairment test under FAS 142, long-lived assets measured at fair value for an impairment assessment under FAS 146.

In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for that Asset Is Not Active", which clarifies the application of SFAS 157 as it relates to the valuation of financial assets in a market that is not active for those financial assets. This FSP is effective immediately and includes those periods for which financial statements have not been issued. The Company currently does not have any financial assets that are valued using inactive markets, and as such is not impacted by the issuance of this FSP.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

In February 2007, the FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment to FASB Statement No. 115," which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The Company adopted this statement as of December 3, 2007 and has elected not to apply the fair value option to any of its financial instruments.

In June 2007, the Emerging Issues Task Force ("EITF") issued EITF 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities," which provides guidance on the accounting for certain nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities. This issue is effective prospectively for fiscal years beginning after December 15, 2007, or fiscal 2009 for the Company. The Company is still assessing the potential impact of adoption.

In December 2007, the FASB issued FAS 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51". This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. This statement will be effective for the Company beginning in fiscal 2010. The Company is still assessing the potential impact of adoption.

In December 2007, the FASB issued FAS 141(R), "Business Combinations—a replacement of FASB Statement No. 141", which significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement is effective prospectively, except for certain retrospective adjustments to deferred tax balances, for fiscal years beginning after December 15, 2008. This statement will be effective for the Company beginning in fiscal 2010. The Company is still assessing the potential impact of adoption.

In March 2008, the FASB issued FAS 161, "Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133", which amends and expands the disclosure requirements of FAS 133 to require qualitative disclosure about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. This statement will be effective for the Company beginning in fiscal 2009. The adoption of this statement will increase the disclosures in the financial statements related to derivative instruments held by the Company.

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Lives of Intangible Assets", which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of an intangible asset. This interpretation is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. The Company will adopt this interpretation as of the beginning of fiscal 2010 and is still assessing the potential impact of adoption.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

In June 2008, the FASB issued FASB Staff Position FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities", which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share. This interpretation is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. The Company will adopt this interpretation as of the beginning of fiscal 2010 and is still assessing the potential impact of adoption.

In November 2008, the Emerging Issues Task Force issued EITF Issue No. 08-06, "Equity Method Investment Considerations", which clarifies the accounting for certain transactions involving equity method investments. This interpretation is effective for financial statements issued for fiscal years beginning on or after December 15, 2008 and interim periods within those years. The Company will adopt this issue as of the beginning of fiscal 2010 and is still assessing the potential impact of adoption.

In December 2008, the FASB issued FASB Staff Position FSP 132(R)-1, "Employers Disclosures about Postretirement Benefit Plan Assets", which provides additional guidance on an employers' disclosures about plan assets of a defined benefit pension or other postretirement plan. This interpretation is effective for financial statements issued for fiscal years ending after December 15, 2009. The Company will adopt this interpretation in fiscal 2010. The adoption of this interpretation will increase the disclosures in the financial statements related to the assets of its defined benefit pension plans.

Revenue Recognition

The Company recognizes revenue when realized or realizable and earned, which is when the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sales price is fixed or determinable; and collectibility is reasonably assured. The recognition criteria are met when title and risk of loss have transferred from the Company to the buyer, which is upon delivery to the customer sites or as determined by legal requirements in foreign jurisdictions. At the time revenue is recognized, the Company provides for the estimated costs of warranties and reduces revenue for estimated returns and cash discounts. The Company also records reductions to revenue for customer incentive programs offered including volume discounts, promotional allowances, slotting fees and supply agreement amortization, in accordance with EITF 01-09, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Product" ("EITF 01-09") and records liabilities pursuant to these agreements. The Company periodically assesses these liabilities based on actual sales and claims to determine whether the customers will meet the requirements to receive rebate funds. The Company generally negotiates these agreements on a customer-by-customer basis. Some of these agreements extend over several periods and are linked with supply agreements. Accordingly, \$101.4 million, \$104.4 million, and \$96.7 million were recorded as a reduction of revenue for fiscal 2008, 2007 and 2006, respectively, associated with EITF 01-09.

Product Delivery Costs

Included in the Company's selling, general and administrative expenses in the consolidated statement of operations for fiscal 2008, 2007 and 2006 were \$91.2 million, \$91.2 million, and \$80.7 million, respectively, in shipping and handling costs associated with the delivery of finished

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

mattress products to its customers, including approximately \$7.3 million, \$8.4 million and \$8.6 million, respectively, of costs associated with internal transfers between plant locations.

Concentrations of Credit and Other Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, receivables, foreign currency forward contracts and interest rate swap arrangements. The Company places its cash and cash equivalents with major financial institutions and limits the amount of credit exposure to any one institution.

The Company's accounts receivable arise from sales to numerous customers in a variety of markets, and geographies around the world. Receivables arising from these sales are generally not collateralized. The Company's customers include furniture stores, national mass merchandisers, specialty sleep shops, department stores, contract customers and other stores. The top five customers accounted for approximately 25.4%, 23.5% and 19.1% of the Company's net sales for the years ended November 30, 2008, December 2, 2007, and November 26, 2006, respectively. No single customer accounted for more than 10% of the Company's net sales in fiscal 2008, 2007 or 2006. During 2008, the economic environment became more challenging and caused a higher occurrence of bankruptcies for mattress retailers and caused many smaller mattress retailers to exit the market. The Company performs ongoing credit evaluations of its customers' financial conditions and maintains reserves for potential credit losses. Such losses, in the aggregate, have not materially exceeded management's estimates.

The counterparties to the Company's foreign currency and interest rate swap agreements are major financial institutions. The Company has not experienced non-performance by any of its counterparties nor does the Company expect there to be non-performance risks associated with our derivative counterparties at November 30, 2008.

The Company is presently dependent upon a single supplier for certain polyurethane foam components in its mattress units manufactured in the Americas. Such components are purchased under a measured supply agreement, and are manufactured in accordance with proprietary process designs exclusive to the supplier. The Company has incorporated these methods of construction into many of its branded products. The Company continues to develop alternative supply sources, allowing acquisition of similar component parts which meet the functional requirement of various product lines. The Company also purchases a portion of its box spring parts from third party sources and manufactures the remainder of these parts. The Company is also dependent on a single supplier for the visco-elastic components and assembly of its *TrueForm* product line. The related product in which these components and assembly processes are used does not represent a significant portion of our overall sales. Except for its dependence regarding certain polyurethane foam and visco-elastic components and assembly of its *TrueForm* product line, the Company does not consider itself to be dependent upon any single outside vendor as a source of supply to its conventional bedding or specialty businesses, and the Company believes that sufficient sources of supply for the same, similar or alternative components are available.

Approximately 58% of the employees at the Company's 25 North American plants are represented by various labor unions with separate collective bargaining agreements. The Company's current collective bargaining agreements, which are typically three years in length, expire at various times beginning in fiscal 2009 through 2011. Of the employees covered by collective bargaining agreements,

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

approximately 45% are under contracts expiring in fiscal 2009. Certain employees at the Company's international facilities are also covered by collective bargaining agreements, which expire at various terms between fiscal 2009 and 2011.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the amount of assets and liabilities and disclosures on contingent assets and liabilities at year end and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the accrued warranty obligation, allowance for doubtful accounts, discounts and returns, cooperative advertising and promotional accruals, valuation of goodwill and intangible assets, reserve for workers' compensation claims, benefit plan obligations and expenses, environmental contingencies and tax assets, liabilities and expense.

See "Warranties" below regarding the effect of changes in estimates associated with the Company's reserve for product warranties.

See "Self-Insurance" below regarding estimates associated with the Company's reserve for workers' compensation claims.

See "Income Taxes" below regarding estimates associated with the Company's valuation allowances against net deferred tax assets.

Foreign Currency

Subsidiaries located outside the U.S. use the local currency as the functional currency. Assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts at average exchange rates during the year. Resulting translation adjustments are recorded directly to a separate component of stockholders' deficit (accumulated other comprehensive income (loss)) and are not tax effected since they relate to investments which are permanent in nature. At November 30, 2008 and December 2, 2007, accumulated foreign currency translation adjustments were \$(5.0 million) and \$20.0 million, respectively. Foreign currency transaction gains and losses are recognized in selling, general and administrative expenses at the time they occur. The Company recorded foreign currency transaction (losses) gains of (\$1.4 million), \$0.5 million, and \$0.5 million in fiscal 2008, 2007, and 2006, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with an original maturity at the time of purchase of three months or less to be cash equivalents. Included as cash equivalents are money market funds that are stated at cost, which approximates market value.

Checks Issued In Excess of Funds on Deposit

Accounts payable and accrued compensation expenses include reclassifications of book overdrafts in the amounts of \$15.8 million and \$0.9 million at November 30, 2008, and \$10.7 million and

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

\$1.4 million at December 2, 2007, respectively. The change in the reclassified amount of checks issued in excess of funds on deposit is included in cash flows from operations in the statements of cash flows.

Inventory

The cost of inventories is determined by the "first-in, first-out" (FIFO) method, which approximates current cost. The cost of inventories includes raw materials, direct labor and manufacturing overhead costs. The Company provides inventory reserves for excess, obsolete or slow moving inventory based on changes in customer demand, technology developments or other economic factors.

Supply Agreements

The Company from time to time enters into long term supply agreements with its customers to sell its branded products to customers in exchange for minimum sales volume or a minimum percentage of the customer's sales or space on the retail floor. Such agreements generally cover a period of two to five years. In these long term agreements, the Company reserves the right to pass on its cost increases to its customers. Other costs such as transportation and warranty costs are factored into the wholesale price of the Company's products and passed on to the customer. Initial cash outlays by the Company are capitalized and amortized generally as a reduction of sales over the life of the contract. The majority of these cash outlays are ratably recoverable upon contract termination. Such capitalized amounts are included in "Prepaid expenses and other current assets" and "Debt issuance costs, net, and other assets" in the Company's Consolidated Balance Sheets.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation expense is provided based on historical cost and estimated useful lives ranging from approximately twenty to forty years for buildings and building improvements and five to fifteen years for machinery and equipment. The Company uses the straight-line method for calculating the provision for depreciation. Depreciation expense for fiscal 2008, 2007, and 2006 was \$30.3 million, \$27.1 million, and \$24.5 million, respectively.

The Company reviews property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets in accordance with FAS 144, "Accounting for the Impairment or Disposal of Long Lived Assets". Impairment charges recognized related to property, plant and equipment within the Americas segment for fiscal 2008 were \$0.9 million and relate to the closure of the Company's manufacturing facility in Clarion, Pennsylvania. These charges have been recorded as a component of restructuring expenses in the Consolidated Statements of Operations (See Note 23). No such charges were recognized in fiscal 2007 or 2006. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Fair value is determined based upon estimates of the amount to be recovered upon disposal of the facility. Such assets which meet the criteria of FAS 144 to be reported as "assets held for sale" are shown as such in the accompanying balance sheets.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

and consist of land and buildings at the Company's closed manufacturing facilities and facilities that the Company is actively marketing for sale and that the Company expects to sell within one year. It is Company policy to capitalize certain costs incurred in connection with developing or obtaining internal-use software.

Goodwill

Goodwill is recorded when the consideration paid for an acquisition exceeds the fair value of the identifiable net tangible and identifiable intangible assets acquired. In accordance with FAS 142, "Goodwill and Other Intangible Assets", goodwill is no longer amortized but must be reviewed for impairment at least annually and if a triggering event were to occur in an interim period. The Company performs at least an annual assessment of goodwill for impairment as of the beginning of the fiscal fourth quarter or whenever events or circumstances indicate that the carrying value of goodwill may not be recoverable from future cash flows. The Company assesses recoverability using several methodologies, which include the present value of estimated future cash flows and comparisons of multiples of enterprise values to earnings before interest, taxes, depreciation and amortization (EBITDA). The analysis is based upon available information regarding expected future cash flows of each reporting unit and discount rates. Discount rates are based upon the cost of capital specific to the reporting unit. If the carrying value of the reporting unit exceeds the discounted fair value of the reporting unit, a second analysis is performed to measure the fair value of all assets and liabilities. If, based on the second analysis, it is determined that the fair value of the assets and liabilities of the reporting unit is less than the carrying value, the Company would recognize impairment for the excess of carrying value over fair value. In connection with its interim evaluation of goodwill in the fourth quarter of 2008, the Company recorded a non-cash charge of \$2.8 million and \$24.7 million related to the impairment of the goodwill of its Puerto Rico and Europe reporting units, respectively (See Note 8). No impairment charges related to goodwill were recognized in fiscal 2007 or 2006.

Debt Issuance Costs

The Company capitalizes costs associated with the issuance of debt and amortizes them as additional interest expense over the lives of the debt on a straight-line basis which approximates the effective interest method. Upon the prepayment of the related debt, the Company accelerates the recognition of an appropriate amount of the costs as interest expense. Additional interest expense arising from such prepayments during the fiscal 2007 and 2006 was \$0.1 million and \$0.3 million, respectively. There were no such prepayments in the year ended November 30, 2008. However, in connection with the Second Amendment to the Third Amended and Restated Credit Agreement, the Company paid fees to the creditor in the amount of \$5.4 million, which were recorded as a component of debt extinguishment and refinancing expenses in the Consolidated Statements of Operations. In accordance with the provisions of EITF 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments" ("EITF 96-19"), these costs were expensed as incurred. The Company also paid approximately \$0.1 million of fees to third parties that were deferred and will be amortized over the

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

life of the amended agreement. The Company has the following amounts recorded in debt issuance costs, net, and other assets:

	November 30, 2008	December 2, 2007
Gross cost	\$ 11,035	\$ 16,863
Accumulated amortization	(2,395)	(5,928)
Net deferred debt issuance costs	\$ 8,640	\$ 10,935

Royalty Income and Expense

The Company recognizes royalty income based on sales of *Sealy*, *Stearns & Foster*, and *Bassett* branded product by various licensees. The Company recognized gross royalty income of \$17.6 million, \$19.2 million, and \$19.2 million in fiscal 2008, 2007, and 2006, respectively. The decrease in royalty income in fiscal 2008 from the levels experienced in fiscal 2007 and fiscal 2006 is based on the decreased sales in the international markets through which we license our product. The Company also pays royalties to other entities for the use of their names on product produced by the Company. The Company recognized royalty expense of \$0.3 million, \$0.6 million, and \$0.4 million, in fiscal 2008, 2007, and 2006 respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method in accordance with FAS 109, "Accounting for Income Taxes". Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company provides valuation allowances against the net deferred tax asset for amounts that are not considered more likely than not to be realized (See Note 15 for disclosure of amounts related to deferred taxes and associated valuation allowances).

Effective December 3, 2007, the Company adopted the provisions of FIN 48. Significant judgment is required in evaluating the Company's federal, state and foreign tax positions and in the determination of its tax provision. Despite management's belief that the Company's liability for unrecognized tax benefits is adequate, it is often difficult to predict the final outcome or the timing of the resolution of any particular tax matters. The Company may adjust these reserves as relevant circumstances evolve, such as guidance from the relevant tax authority, its tax advisors, or resolution of issues in the courts. The Company's tax expense includes the impact of reserve provisions and changes to reserves that it considers appropriate, as well as related interest. These adjustments are recognized as a component of income tax expense entirely in the period in which they are identified. The Company is currently undergoing examinations of its corporate income tax returns by tax authorities, no issues related to these reserved positions have been presented to the Company. The Company believes that such audits will not result in an assessment and payment of taxes related to these positions during the one year following December 2, 2007.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: *Basis of Presentation and Significant Accounting Policies (Continued)*

Advertising Costs

The Company expenses all advertising costs as incurred. In accordance with EITF 01-09, the estimated fair value of cooperative advertising costs paid to customers are recorded as a component of selling, general and administrative expense within the Consolidated Statements of Operations when the customer provides proof of advertising. We periodically assess the liabilities recorded for cooperative advertising based on actual sales and claims to determine whether all of the cooperative advertising earned will be used by the customer. Advertising expenses, including cooperative advertising, for fiscal 2008, 2007, and 2006 amounted to \$155.5 million, \$188.9 million, and \$162.5 million, respectively.

Warranties

The Company's warranty policy provides a ten year non-prorated warranty service period on all currently manufactured *Sealy Posturepedic*, *Stearns & Foster* and *Bassett* bedding products and some other *Sealy* branded products and a twenty year warranty period on the major components of our *TrueForm* and *MirrorForm* visco-elastic products as well as our *SpringFree* latex product, the last ten years of which are prorated on a straight-line basis. In 2006, the Company introduced *Right Touch*, which has a twenty year limited warranty that covers only certain parts of the product and is prorated for part of the twenty years; however, the *Right Touch* line was discontinued in the third quarter of fiscal 2008. The Company's policy is to accrue the estimated cost of warranty coverage at the time the sale is recorded based on historical trends of warranty costs. The estimate involves an average lag time in days between the sale of a bed and the date of its return, applied to the current rate of warranty returns.

In 2007, the Company amended its warranty policy on *Sealy* branded promotional bedding to three years for the new line introduced in January 2007 and shipped in the second quarter of fiscal 2007. The impact of this change to the warranty policy did not have a significant impact on the Company's financial results or position.

During fiscal 2008, the Company completed an analysis of its returns claims experience based on historical return trends for the Company's U.S. business, which is a component of the Americas segment, using newly available information as a result of a new and improved product return process that allows it to better track and match claims received to the sales for which those claims were initially recorded. This analysis was applied to both its warrantable and other product returns. The effect of this change in estimate for warranty claims was to reduce other accrued liabilities and cost of sales by approximately \$2.5 million. The change in estimate for other product returns increased accounts receivable balances by approximately \$3.7 million, with a corresponding increase in net sales. For fiscal 2008, the change in estimate increased operating income by \$6.2 million and net income by \$3.8 million. This change in estimate also increased net income per both basic and diluted share by \$0.04 for fiscal 2008.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

The change in the Company's accrued warranty obligations for the fiscal 2008, 2007 and 2006 was as follows:

	2008	2007	2006
Accrued warranty obligations at beginning of period	\$ 15,964	\$ 15,349	\$ 14,321
Warranty claims(1)	(20,034)	(17,389)	(15,832)
Warranty provisions(2)	23,032	18,004	16,860
Change in estimate (see Note 4)	(2,475)	—	—
Accrued warranty obligations at end of period	<u>\$ 16,487</u>	<u>\$ 15,964</u>	<u>\$ 15,349</u>

(1)

Warranty claims for the year ended November 30, 2008 include approximately \$11.9 million for claims associated with products sold prior to December 2, 2007 that are still under warranty. In estimating its warranty obligations, the Company considers the impact of recoverable salvage value on warranty cost in determining its estimate of future warranty obligations. The Company utilizes warranty trends on existing similar product in order to estimate future warranty claims associated with newly introduced product. Warranty claims and provisions shown above do not include estimated salvage recoveries that reduced cost of sales by \$5.9 million, \$6.2 million, and \$5.5 million for fiscal 2008, 2007 and 2006, respectively.

(2)

The provision for fiscal year 2008 includes an increase of approximately \$0.5 million relating to decreased recoverable salvage value included in the warranty obligation estimate. The provision for fiscal year 2007 includes a decrease of approximately \$2.1 million relating to increased recoverable salvage value included in the warranty obligation estimate. The provision for fiscal year 2006 includes a decrease of approximately \$1.7 million relating to increased recoverable salvage value included in the warranty obligation estimate.

Self-Insurance

The Company is self-insured for certain losses related to medical claims with excess loss coverage of \$375,000 per claim per year. The Company also utilizes large deductible policies to insure claims related to general liability, product liability, automobile, and workers' compensation. The Company's recorded liability represents an estimate of the ultimate cost of claims incurred as of the balance sheet date. The estimated liability is discounted and is established based upon analysis of historical data and actuarial estimates, and is reviewed by management and third-party actuaries on a quarterly basis to ensure that the liability is appropriate. While the Company believes these estimates are reasonable based on the information currently available, if actual trends, including the severity or frequency of claims, medical cost inflation, or fluctuations in premiums, differ from the Company's estimates, the Company's results of operations could be impacted. During fiscal 2008, we recognized a reduction of reserves of \$1.3 million. This was in part due to a continued reduction in the severity and number of claims. Also contributing to the decrease in the reserve was a prepayment of claims that was made prior to November 30, 2008. During fiscal 2007, the Company recognized a reduction of reserves totaling \$0.9 million due to favorable loss development from a reduction in both the frequency and severity of historical claims experience. During fiscal 2006, the Company recognized a reduction of reserves totaling \$5.7 million, which included a \$2.3 million change in estimate due to a change from industry loss development factors to the Company's own historical loss development factors. The

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

remaining change relates to favorable loss development due to a reduction in both the frequency and severity of historical claims experience. These charges related to plant labor and are therefore included in cost of goods sold for the period.

Research and Development

Product development costs are charged to operations during the period incurred and are not considered material.

Environmental Costs

Environmental expenditures that relate to current operations are expensed or capitalized, as appropriate, in accordance with AICPA Statement of Position 96-1, "Environmental Remediation Liabilities". Expenditures that relate to an existing condition caused by past operations and that do not provide future benefits are expensed as incurred. Liabilities are recorded when environmental assessments are made or the requirement for remedial efforts is probable, and the costs can be reasonably estimated. The timing of accruing for these remediation liabilities is generally no later than the completion of feasibility studies. The Company has an ongoing monitoring and identification process to assess how the activities, with respect to the known exposures, are progressing against the accrued cost estimates, as well as to identify other potential remediation sites that are presently unknown.

Conditional Asset Retirement Obligations

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143" ("FIN 47"). This interpretation clarifies the term "conditional asset retirement obligation" as used in FAS 143 and provides additional guidance on the timing and method for the recognition and measurement of such conditional obligations. FIN 47 became effective for fiscal years ending after December 15, 2005. The Company adopted FIN 47 as of the beginning of fiscal 2006 and has recorded an adjustment as of November 28, 2005, the first day of fiscal 2006, of approximately \$0.3 million, net of income tax benefit of \$0.2 million, to recognize the cumulative effect of the accounting change. In addition, the Company recorded \$0.1 million in property, plant and equipment and a liability of \$0.6 million in other noncurrent liabilities as of November 28, 2005. The initial obligations recognized resulted from obligations in certain of the Company's facility leases that require the Company to return those properties to the same or similar condition at the end of the lease as existed when the Company began using those facilities. Although the lease termination dates range from 2009 to 2023, the Company may be able to renegotiate such leases to extend the terms. After the initial adoption of FIN 47, the Company entered into additional leases with provisions similar to those described above which required the recognition of additional asset retirement obligations in fiscal 2006, 2007, and 2008.

In addition to the above obligations, the Company also owns certain factories that contain asbestos. Current regulations require that the Company remove and dispose of asbestos if the factory undergoes major renovations or is demolished. Although the Company is not required to remove the asbestos unless renovation or demolition occurs, it is required to monitor and ensure that it remains stable and is required to notify any potential buyer of its existence. In the fourth quarter of fiscal 2006, the Company recognized an asset retirement obligation of \$0.1 million to remove asbestos at a U.S.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

facility that was renovated in the second quarter of fiscal 2007. Also, in fiscal 2007, the Company removed asbestos at a European facility. The Company has recognized an asset retirement obligation of \$0.2 million for the remaining asbestos in its European facilities. The Company has not recognized asset retirement obligations in its financial statements for asbestos at any other facilities because management believes that there is an indeterminate settlement date for the retirement obligation as the range of time over which the Company may be required to remove and dispose of the asbestos is unknown or cannot be estimated. The Company currently has no plans to demolish a factory or to undertake a major renovation that would require removal of the asbestos at any of these other facilities. Management will continue to monitor this issue and will record an asset retirement obligation when sufficient information becomes available to estimate the obligation.

FIN 47 results in the ongoing recognition of costs related to the depreciation of the assets and the accretion of the liability. The Company recognized accretion and depreciation expense of \$0.1 million in fiscal 2008 and 2007. An insignificant amount of accretion and depreciation expense was recognized in fiscal 2006. A reconciliation of the carrying amount of our asset retirement obligation which is recorded as a component of other noncurrent liabilities in the Consolidated Balance Sheets for the years ended November 30, 2008 and December 2, 2007 is as follows:

	<u>2008</u>	<u>2007</u>
	(in thousands)	
Asset retirement obligations at beginning of year	\$ 1,322	\$ 1,112
Liabilities incurred	129	273
Payments made	—	(125)
Revisions in estimated cash flows	137	—
Reversal of obligation for facilities exited	(126)	—
Accretion expense	50	62
Asset retirement obligations at end of year	<u>\$ 1,512</u>	<u>\$ 1,322</u>

Derivative Financial Instruments

The Company uses financial instruments, including forward exchange and swap contracts to manage its exposures to movements in interest rates and foreign exchange rates. The use of these financial instruments allows the Company to reduce its overall exposure to fluctuations in interest rates and foreign exchange rates.

The Company formally documents its hedging relationships, including identifying the hedging instruments and the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction. The Company also formally assesses, both at inception and at least quarterly thereafter, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the cash flows of the hedged item. The effective portion of the change in fair value of a derivative is recorded as a component of accumulated other comprehensive income in the Consolidated Balance Sheets. When the hedged item affects the income statement, the gain or loss included in accumulated other comprehensive income is reported on the same line in the Consolidated Statements of Operations as the hedged item. In addition, any ineffective portion of the changes in the fair value of derivatives used as cash flow hedges and the changes in the fair value related to those hedging instruments that are not designated as hedges for accounting purposes are reported in the

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 1: Basis of Presentation and Significant Accounting Policies (Continued)

Consolidated Statements of Operations as the changes occur. If it is determined that a derivative ceases to be a highly effective hedge, or if the anticipated transaction is no longer likely to occur, the Company discontinues hedge accounting and any deferred gains or losses are recorded in the Consolidated Financial Statements.

Derivatives are recorded in the Consolidated Balance Sheets at fair value which is based upon an income approach which consists of a discounted cash flow model that takes into account the present value of the future cash flows under the terms of the contracts using current market information as of the reporting date such as prevailing interest rates and foreign currency spot and forward rates.

Share-Based Compensation

The Company has adopted the provisions of FAS No. 123 (revised 2004) "Share Based Payment" ("FAS 123(R)"). The Company applies the provisions of FAS 123(R) prospectively to new awards and to awards modified, repurchased, or cancelled (See Note 3). The Company elected to use the alternative short cut method described in FASB Staff Position 123(R)-3 for determining the pool of available paid in capital against which any future tax benefit deficiencies arising from the exercise of options may be offset (the "APIC pool"). The Company shall continue to account for any portion of awards outstanding at August 29, 2005 using the provisions of Accounting Principles Board Opinion No. 25, as previously permitted under FAS 123.

Commitments and Contingencies

The Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 2: Initial Public Offering of Common Stock and Use of Proceeds

On April 12, 2006, the Company completed an IPO of its common stock, raising \$299.2 million of net proceeds after deducting the underwriting discount. The following table presents the sources and uses of cash from the IPO:

	(in millions)
Source of Proceeds:	
Gross proceeds from issuance of 20 million shares of common stock at \$16.00 per share	\$ 320.0
Use of Proceeds:	
Cash dividend to shareholders of record immediately prior to the IPO	\$ 125.0
Repayment of Senior Subordinated PIK Notes, including 1% prepayment penalty thereon(1)	90.0
Repurchase of \$47.5 million aggregate principal amount of the 2014 Notes, plus market premiums of \$2.7 million(1) and accrued interest of \$1.4 million	51.6
Underwriting discount at \$1.04 per share for 20 million shares	20.8
Cash bonuses to members of management(2)	17.5
Management Services Agreement termination fee paid to KKR(2)	11.0
Other fees and expenses associated with the IPO(3)	3.9
Net cash available for use by the Company	0.2
Total uses of proceeds from the IPO	\$ 320.0

(1) PIK Note penalty of \$0.9 million and Note repurchase premium of \$2.7 million are included in "debt extinguishment and refinancing expenses" in the Consolidated Statements of Operations for the year ended November 26, 2006.

(2) Bonuses of \$17.5 million and fee of \$11.0 million are included in "expenses associated with initial public offering of common stock" in the accompanying statements of operations for the year ended November 26, 2006.

(3) Direct costs of IPO were charged against additional paid in capital in the accompanying consolidated balance sheet. At November 26, 2006, there were no material unpaid fees associated with the IPO.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 2: Initial Public Offering of Common Stock and Use of Proceeds (Continued)

The Consolidated Statements of Operations for the year ended November 26, 2006 also include the following charges related to the IPO and associated debt extinguishments:

	(in millions)
Cash charges:	
Compensation expense associated with transaction bonuses	\$ 17.5
Fee paid to KKR for termination of Management Services Agreement	11.0
Total charges included in "expenses associated with initial public offering of common stock"	28.5
Cash premiums and prepayment penalties totaling \$3.6 million plus non-cash charges of \$1.7 million resulting from the repurchase of 2014 Notes and retirement of PIK Notes, included in "debt extinguishment and refinancing expenses"	5.3
Non-cash compensation resulting from the conversion of certain equity share options into common stock, included in "selling, general and administrative expenses"	0.4
Total charges related to the IPO	\$ 34.2

Note 3: Share-Based Compensation

Share-Based Payment Arrangements

At November 30, 2008, the Company has five share-based compensation plans as described below. The compensation cost that has been charged against income for those plans, included in selling, general and administrative expenses for fiscal years 2008, 2007, and 2006 was \$3.4 million, \$3.0 million, and \$2.6 million, respectively. The non-cash compensation expense recognized for the fiscal year 2008 includes a charge of approximately \$0.9 million related to modifications of awards given to certain former executive officers of the Company. This charge has been recorded as a component of selling, general and administrative expenses in the Consolidated Statements of Operations. The total income tax benefit recognized in the statements of operations for share based compensation arrangements was \$1.3 million, \$1.2 million, and \$1.1 million for fiscal years 2008, 2007, and 2006, respectively. No share based compensation cost has been capitalized and included in any assets in the accompanying consolidated balance sheets. Cash received from the exercise of share options under all plans during fiscal 2008, 2007, and 2006 was \$0.1 million, \$0.9 million, and \$0.1 million, respectively, with tax benefits realized upon exercise during each fiscal year of \$3.0 million, \$8.1 million, and \$3.8 million, respectively.

1998 Plan

Prior to the merger with KKR, all outstanding options were issued under the 1998 Stock Option Plan ("1998 Plan"). Options under the 1998 Plan were granted as Nonqualified Stock Options subject to the provisions of Section 83 of the Internal Revenue Code. The options vested either 20% on the first through fifth anniversary of the grant or 40% upon the second anniversary, and 20% on the third, fourth and fifth anniversary dates of the grant. On April 6, 2004, all outstanding options under the 1998 Plan, whether or not vested, other than certain options held by members of management that those members elected to rollover (the "Rollover Options"), were cancelled and converted into a right to receive cash consideration upon the completion of the merger with KKR. The Rollover Options,

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 3: Share-Based Compensation (Continued)

which had an aggregate initial intrinsic value of \$24.6 million at the time of the merger with KKR, represent options to purchase Class A common stock in Sealy Corporation and are fully vested. The expiration dates of the existing options converted to Rollover Options were uniformly extended to ten years from the date of the merger, thus resulting in a new measurement date and recognition of expense for the intrinsic value. Unless modified subsequent to August 29, 2005, all Rollover Options which remain outstanding will continue to be accounted for using the intrinsic value method of APB 25 in accordance with the transition method described above. Because all options under the 1998 Plan are accounted for under the intrinsic value method with the minimum value method having been used for disclosure purposes in previously issued financial statements, no information is presented herein with regard to significant assumptions used for fair value estimation purposes or regarding weighted average grant date fair value. At November 30, 2008, there is no unrecognized compensation cost related to the 1998 Plan. A summary of option activity under the 1998 Plan as of November 30, 2008, and changes for the year then ended, is presented below:

	Shares Subject to Options	Weighted Average Exercise Price Per Share
Outstanding December 2, 2007	3,109,454	\$ 1.44
Exercised	(1,173,976)	1.35
Outstanding November 30, 2008 (all fully vested and exercisable)	1,935,478	\$ 1.50
Weighted average remaining contractual term	5.4 years	
Aggregate intrinsic value at November 30, 2008 (in thousands)	\$ 2,921	

2004 Plan

The Company's Board of Directors adopted the 2004 Stock Option Plan for Key Employees of Sealy Corporation and its Subsidiaries ("2004 Plan") that provides for the grant of cash and cashless exercise stock options, restricted stock awards, stock appreciation rights and/or dividend equivalent rights to management, other key employees and non-employee directors on terms and subject to conditions as established by the Compensation Committee of Sealy Corporation's Board of Directors or certain of the committee's designees. The 2004 Stock Option Plan provided twenty million shares of Class A common stock for grants as new shares. Upon Sealy's March 23, 2006 reverse stock split of 0.7595, the Company has taken the position that only 15,190,000 shares are reserved for grants under the 2004 Stock Option Plan.

Options under the 2004 Plan are granted in part as: 1) "time options," which vest and become exercisable ratably on a monthly basis generally over the first three to five years following the date of grant; 2) "old performance options," which were granted prior to fiscal 2008 and vest and become exercisable over the fiscal years through fiscal year 2008 upon the achievement of certain EBITDA performance targets, and in any event by the eighth anniversary of the date of grant; and 3) "new performance options," issued during fiscal 2008, which vest and become exercisable only upon achievement of certain EBITDA performance targets and do not have a time vesting component. As of November 30, 2008, approximately 6,067,516 million time options and 3,881,004 million performance options were issued and outstanding. The Company has not met the EBITDA performance targets for fiscal 2008 for the old performance options; thus, the 2008 and 2007 portions of these options have not become vested based on the accelerated vesting provisions. Since management has determined that the

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 3: Share-Based Compensation (Continued)

cumulative EBITDA performance targets for the old performance options granted between the third fiscal quarter of 2006 and the end of fiscal 2007 will not be met, these performance options are being amortized over the first eight years following the date of grant. Management has also determined that the cumulative EBITDA performance targets for the new performance options granted during fiscal 2008 will not be met and therefore has not recognized any compensation expense related to options to purchase 674,532 shares of common stock since these options do not vest if the performance targets are not achieved. Approximately 49% of the total outstanding performance options are vested as of November 30, 2008.

Unless modified subsequent to August 29, 2005, all options issued under the 2004 Plan, which were outstanding at August 29, 2005, will continue to be accounted for using the intrinsic value method of APB 25. Options granted under the 2004 plan subsequent to that date will be accounted for using the fair value method under FAS 123(R).

As of November 30, 2008, there was \$6.7 million of unrecognized compensation costs associated with grants under the 2004 Plan. That cost is expected to be recognized over a weighted average period of 5.1 years. The weighted average grant date fair value for all option grants during fiscal 2008, 2007 and 2006 was \$2.04, \$5.16, and \$4.79 per option, respectively. The total intrinsic value of options exercised during fiscal 2008, 2007 and 2006 were \$8.4 million, \$21.0 million, and \$9.9 million, respectively. The Company valued these stock option grants using the Black-Scholes valuation model or the trinomial lattice model as appropriate under the circumstances, with the following assumptions:

	Year ended		
	November 30, 2008	December 2, 2007	November 26, 2006
Expected volatility	40% - 60%	30%	30%
Expected dividend yield	0.00% - 3.35%	1.76% - 2.24%	1.86% - 2.42%
Expected term (in years)	5.66 - 6.53	6.71 - 8.39	5.00 - 9.29
Risk free rate	1.35% - 3.48%	4.19% - 4.85%	4.69% - 5.21%

Due to the lack of sufficient historical trading information with respect to its own shares, the Company estimates expected volatility based on a portfolio of selected stocks of companies believed to have market and economic characteristics similar to its own. The expected dividend yield is based on the Company's then current quarterly dividend of \$0.075 per share relative to the fair value of the underlying stock at grant date for options granted prior to the suspension of the dividend in the second quarter of fiscal 2008. The expected dividend yield for options granted after the decision was made to suspend the dividend was assumed to be zero. Expected term is estimated based on the simplified method allowed under Staff Accounting Bulletin No. 107, issued by the United States Securities and Exchange Commission, for options valued using the Black-Scholes valuation model. For options valued using the trinomial lattice model, expected term is based on an analysis of the early exercise behavior of employees. The risk free rate is based on the U.S. Treasury yield curve in effect at the time of grant.

The Company also recognized compensation expense during fiscal 2006 related to 192,236 options which were converted to shares of stock in connection with the IPO on April 6, 2006. Non-cash compensation of approximately \$0.4 million, reflecting the excess of the fair value of the shares received over the fair value of the options converted, is included in selling, general and administrative expenses. Cash compensation expense of approximately \$2.8 million, resulting from the payment of taxes on behalf of employees benefiting from the conversion, is included in "expenses associated with initial public offering of common stock" in the accompanying Consolidated Statements of Operations.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 3: Share-Based Compensation (Continued)

A summary of option activity under the 2004 Plan as of November 30, 2008, and changes for the year then ended, is presented below:

	Shares Subject to Options	Weighted Average Exercise Price Per Share
Outstanding December 2, 2007	9,304,343	\$ 8.06
Granted	3,396,805	\$ 5.29
Exercised	(162,154)	\$ 5.78
Forfeited	(2,590,474)	\$ 8.81
Outstanding November 30, 2008	9,948,520	\$ 6.96
Weighted average remaining contractual term	6.3 years	
Aggregate intrinsic value (in thousands)	\$ 0	
Exercisable at November 30, 2008	4,884,594	
Weighted average remaining contractual term	6.0 years	
Aggregate intrinsic value (in thousands)	\$ 0	

Special Retiree Put Obligations

Concurrent with the merger with KKR in 2004, three officers of the Company were given options to sell their shares of stock in Sealy Corporation back to the Company upon their retirement. The sales price per share is based on a formula which takes into account changes in the Company's equity since the merger and recapitalization, including, among other things, consolidated net income, additional capital contributions, and capital distributions. The Company recognized an initial retiree put obligation concurrent with the recapitalization of approximately \$2.5 million to recognize the resulting obligation to repurchase shares retained by Company stockholders prior to the April 6, 2004 merger with KKR ("Rollover Shares") held by these officers. Subsequent changes in the calculated sales price per share, primarily resulting from the consolidated net income of Sealy Corporation and subsidiaries subsequent to the merger with KKR in 2004 and the IPO in 2006, dividend distributions in July 2004 and quarterly since the IPO, and certain other equity transactions resulted in compensation expense of \$0.2 million, \$0.5 million and \$0.1 million for the fiscal years 2008, 2007, and 2006, respectively. This expense is recorded as a component of selling, general and administrative expense. The right to sell the vested shares of the Company's common stock expired during fiscal 2008 and \$1.5 million of the related liability has been reclassified from other noncurrent liabilities to common stock and options subject to redemption and \$2.4 million of the related liability has been reclassified from other noncurrent liabilities to additional paid in capital within the accompanying Consolidated Balance Sheet as of November 30, 2008 (See Note 21). The balance of the retiree put obligation, included in other noncurrent liabilities, at December 2, 2007 was \$3.7 million. The Company's method of accounting for the retiree put obligation did not change as a result of its adoption of FAS 123(R).

Restricted Share Awards

During the third quarter of fiscal 2008, the Board of Directors of the Company approved a grant to the President and Chief Executive Officer of the Company of 291,971 restricted shares of Company common stock. Two-thirds of such restricted shares will vest on the second anniversary of the grant date, and one-third of such restricted shares will vest on the third anniversary of the grant date. On November 6, 2008, affiliates of Kohlberg Kravis Roberts & Co. L.P. delivered to the Company a written

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 3: Share-Based Compensation (Continued)

consent of shareholders approving amendments to the 2004 Plan, which permits the grant of restricted stock awards under the 2004 Plan. Since this approval was considered perfunctory after the Board of Directors approval of the issuance of these shares and the related amendments to the plan document the Company treated these shares as having been granted on July 22, 2008.

The 291,971 restricted shares outstanding have a grant date fair value of \$6.85 based on the closing price of the Company's common stock as of the date of grant which is considered to be representative of fair value. The rights associated with these shares are the same as those of the Company's outstanding common shares (Note 22) except that they cannot be sold by the holder until the end of the vesting period. Compensation expense recognized during fiscal 2008 related to these restricted shares was \$0.2 million. As of November 30, 2008, the remaining unrecognized compensation cost related to restricted stock awards was \$1.8 million, which is expected to be recognized over the remaining vesting period of 2.6 years. As of November 30, 2008, none of the outstanding restricted stock awards have vested.

Directors' Deferred Stock Compensation

Under the Sealy Corporation Directors' Deferred Compensation Plan, adopted as of the beginning of fiscal 2005, the members of the Company's Board of Directors may make an annual election to receive their fees in the form of equity share units in lieu of cash. The number of units received is determined based on the number of shares that could be purchased with the directors' fees at the current fair value of the shares. Directors will receive additional units for shares that could be purchased with future dividends, if any. Following a director's departure from the board, but no sooner than six months thereafter, the director may receive payment for the balance of the deferred compensation share units. The form of payment, whether in shares of stock or in cash equivalent to the fair value of the shares at the time of payment, is at the discretion of the Company. The Company accounts for share units issued under the Plan as equity awards, recognizing a charge against earnings for the compensation expense associated with the Plan, with a corresponding credit to additional paid-in capital. Share units issued following the adoption of FAS 123(R) are not adjusted for subsequent changes in the fair value of the underlying stock, although units outstanding at the date of adoption continue to be so adjusted. During fiscal 2008, the Company recognized an insignificant amount of compensation expense related to this Plan. During the fiscal years 2007 and 2006, the Company recognized compensation expense of \$0.3 million and \$0.5 million, respectively, related to this Plan. A summary of share unit activity under the Sealy Corporation Directors' Deferred Compensation Plan as of November 30, 2008, and changes for the year then ended, is presented below:

	Share Units	Weighted Average Grant Date Fair Value
Outstanding December 2, 2007	78,752	\$ 11.58
Granted	56,532	5.83
Outstanding November 30, 2008 (all fully vested at grant date)	135,284	\$ 9.17

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 4: Change in Estimate

During fiscal 2008, the Company completed an analysis of its returns claims experience based on historical return trends for the Company's U.S. business, which is a component of the Americas segment, using newly available information as a result of a new and improved product return process that allows it to better track and match claims received to the sales for which those claims were initially recorded. This analysis was applied to both its warrantable and other product returns. The effect of this change in estimate for warranty claims was to reduce other accrued liabilities and cost of sales by approximately \$2.5 million. The change in estimate for other product returns increased accounts receivable balances by approximately \$3.7 million, with a corresponding increase in net sales. For the year ended November 30, 2008, the change in estimate increased operating income by \$6.2 million and net income by \$3.8 million. This change in estimate also increased net income per both basic and diluted share by \$0.04 for the year ended November 30, 2008.

Note 5: Inventories

The components of inventory as of November 30, 2008 and December 2, 2007 were as follows:

	November 30, 2008	December 2, 2007
Raw materials	\$ 27,335	\$ 30,327
Work in process	29,140	27,647
Finished goods	8,159	15,708
	<u>\$ 64,634</u>	<u>\$ 73,682</u>

Note 6: Assets Held for Sale

The Company sold assets held for sale with a carrying value of \$2.3 million in March 2007. In connection with this sale, a pretax gain on sale of the facility of approximately \$2.6 million was recorded as a reduction of selling, general and administrative expenses in the Consolidated Statements of Operations.

Note 7: Assets Constructed on Behalf of the Company

The Company has engaged third parties to construct production facilities to be leased by the Company. EITF No. 97-10, "The Effect of Lessee Involvement in Asset Construction" ("EITF 97-10"), is applied to entities involved with certain structural elements of the construction of an asset that will be leased when construction of the asset is completed. EITF 97-10 requires the Company to be considered the owner, for accounting purposes, of these production facilities. Accordingly, in fiscal 2007, the Company recorded an additional \$5.2 million in property, plant and equipment with an offsetting financing obligation in the Consolidated Balance Sheets for a facility that was placed in service in February 2007. In fiscal 2008, the Company amended one of these leases which had the effect of extending the lease term. Based on this amendment, an additional \$1.6 million of property, plant and equipment with an offsetting financing obligation was recognized in the Consolidated Balance Sheets. During the lease terms, the Company recognizes building depreciation and interest expense for the obligations. The Company has recorded \$38.4 million and \$39.0 million as of November 30, 2008 and December 2, 2007, respectively in buildings related to these facilities. The associated financial obligations are \$42.3 million and \$41.7 million as of November 30, 2008 and December 2, 2007, respectively in the Consolidated Balance Sheets. The recording of these assets is a non-cash item for the purposes of the Consolidated Statements of Cash Flow.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 8: Goodwill and Other Intangible Assets

The Company assesses goodwill at least annually for impairment as of the beginning of the fiscal fourth quarter or whenever events or circumstances indicate that the carrying value of goodwill may not be recoverable from future cash flows. The Company assesses recoverability using several methodologies, including the present value of estimated future cash flows and comparisons of multiples of enterprise values to earnings before interest, taxes, depreciation and amortization (EBITDA). The analysis is based upon available information regarding expected future cash flows of each reporting unit discounted at rates consistent with the cost of capital specific to the reporting unit. If the carrying value of the reporting unit exceeds the indicated fair value of the reporting unit, a second analysis is performed to measure the fair value of all assets and liabilities. If, based on the second analysis, it is determined that the implied fair value of the goodwill of the reporting unit is less than the carrying value, goodwill is considered impaired.

In the fourth quarter of fiscal 2008, market conditions deteriorated significantly. This deterioration resulting from the global economic downturn had not yet matured or been considered in our annual test of goodwill. Because of the potential impact of these conditions on the Company's projections and the indicated fair value of our reporting units, the Company performed an interim evaluation of goodwill in the fourth quarter of 2008 reflecting its current views regarding the impact of the changed economic environment. This analysis indicated potential impairment in the goodwill of the Europe and Puerto Rico reporting units. As a result the Company estimated the implied fair value of the goodwill in those reporting units compared to carrying amounts and recorded an impairment charge of \$27.5 million to impair goodwill of \$2.8 million recorded in the Puerto Rico reporting unit and \$24.7 million in the Europe reporting unit. The impairment charge is based upon estimates of the fair value of property and equipment and certain intangible assets, including customer relationships. The Company will finalize these estimates in the first quarter of fiscal 2009.

The expected volatility in the price of our steel and petroleum-based components and the current uncertainty in the credit and equity markets may impact the estimates used in evaluating goodwill and indefinite-lived intangible assets for potential impairment. In light of these changes in market conditions, we will continue to monitor impairment indicators across our reporting units.

No impairment of goodwill was identified related to the Company's other reporting units or its other intangible assets. The Company did not record any impairment charges during fiscal 2007 or 2006 related to goodwill or other intangible assets.

The changes in the carrying amount of goodwill for the years ended November 30, 2008 and December 2, 2007 are as follows:

	<u>Americas</u>	<u>Europe</u>	<u>Total</u>
		(in thousands)	
Balance as of November 26, 2006	\$ 362,675	\$ 25,529	\$ 388,204
Increase due to foreign currency translation	4,268	2,988	7,256
Balance as of December 2, 2007	366,943	28,517	395,460
Impairment loss	(2,831)	(24,644)	(27,475)
Decrease due to foreign currency translation	(6,963)	(3,873)	(10,836)
Balance as of November 30, 2008	\$ 357,149	\$ —	\$ 357,149

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 8: Goodwill and Other Intangible Assets (Continued)

Other intangibles as of November 30, 2008 and December 2, 2007, which are all in the Americas segment, consisted of the following:

	<u>2008</u>	<u>2007</u>
	(in thousands)	
Licenses	\$ 18,379	\$ 20,478
Less accumulated amortization	(13,434)	(11,612)
Total other intangibles	\$ 4,945	\$ 8,866

Licenses are amortized on the straight-line method over periods ranging from 5 to 15 years. The Company expects to recognize amortization expense relating to these intangibles of \$3.0 million in 2009, \$0.5 million in 2010, \$0.3 million in 2011, \$0.3 million in 2012, \$0.3 million in 2013 and \$0.5 million thereafter.

In connection with the adoption of FAS 158 as discussed in Note 16, the intangible pension asset for unamortized prior service costs was eliminated in fiscal 2007 as an adjustment to accumulated other comprehensive income.

Note 9: Long Term Obligations

Long term debt as of November 30, 2008 and December 2, 2007 consisted of the following:

	<u>November 30, 2008</u>	<u>December 2, 2007</u>
	(in thousands)	
Senior revolving credit facility	\$ 64,400	\$ 41,600
Senior secured term loans	377,181	403,393
Senior subordinated notes	273,945	273,945
Financing obligations(1)	42,348	41,674
Other	25,531	33,143
	<u>783,405</u>	<u>793,755</u>
Less current portion	(21,243)	(36,433)
	<u>\$ 762,162</u>	<u>\$ 757,322</u>

(1) Financing obligations are related to facilities in which the Company was involved in the construction that have been capitalized in accordance with EITF 97-10. The related leases have terms ranging from 10 to 16 years.

Senior Credit Facility

On August 25, 2006, the Company entered into the Third Amended and Restated Credit Agreement (the "Third Amended and Restated Credit Agreement"), which amended and restated the Second Amended and Restated Credit Agreement. The Third Amended and Restated Credit Agreement refinanced the \$440 million then outstanding under the Second Amended and Restated Credit Agreement in two tranches, Tranche A for \$300 million maturing August 25, 2011 and Tranche E for \$140 million maturing August 25, 2012. The Third Amended and Restated Credit Agreement also reduced the applicable interest rate margins charged on the senior secured term loan, provided certain financial leverage ratio tests are met. In addition, the Third Amended and Restated

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 9: Long Term Obligations (Continued)

Credit Agreement provided Sealy Corporation with greater flexibility to receive dividend distributions from its subsidiaries, or to repay certain subordinated debt, provided certain leverage ratio tests and other conditions are met.

On November 28, 2007, the Company entered into a First Amendment to the Third Amended and Restated Credit Agreement which, subject to certain restrictions, permits Sealy Canada, Ltd., a 100% owned subsidiary of Sealy Corporation and a borrower under the senior credit facility, to declare and pay dividends to a U.S. subsidiary of Sealy Corporation that is also a guarantor of the senior credit facility.

On November 14, 2008, the Company entered into the Second Amendment to the Third Amended and Restated Credit Agreement. This amendment lessened the restrictions under the financial leverage and interest coverage ratios and increased the applicable interest rate margins charged on the senior secured term loans, by 325 basis points on the \$300 million Tranche A loan and 300 basis points on the \$140 million Tranche E loan. In addition, this amendment also increased the percentage of excess cash flow that is required to be used to prepay loans beginning with the 2009 fiscal year.

As of November 30, 2008, there was \$270.0 million outstanding under Tranche A of the senior secured term loan due in 2011 and \$107.2 million outstanding under Tranche E of the senior secured term loan due in 2012. Tranche A of the term loan facility requires quarterly principal payments of 1.25% of the then outstanding principal amount from November 2007 through August 2010 and quarterly principal payments of 21.25% of the then outstanding principal amount from November 2010 through the maturity date of August 25, 2011. During the fourth quarter of fiscal 2008, the Company made a voluntary prepayment on its Tranche A term loan of \$11.3 million. This prepayment was allocated to the mandatory principal payments under Tranche A due in February, May and August of 2009. During the second quarter of fiscal 2007, the Company made a voluntary prepayment on its Tranche E term loan and as a result has no further scheduled payment on that Tranche until the maturity date. The Company may be required to make mandatory principal prepayments depending on certain financial ratios. At November 30, 2008, no payment is required with respect to excess cash flow for the 2009 fiscal year, and as such, no amount has been reclassified to current for an anticipated principal repayment.

The Company's senior credit facility includes a \$125 million senior revolving credit facility, the amount of which was not modified by the Second Amendment to the Third Amended and Restated Credit Agreement. However, this amendment did increase the applicable margin related to the senior revolving credit facility from 1.75% to 4.50%. The Company may borrow up to \$25 million of the \$125 million senior revolving credit facility in Canada. As of November 30, 2008, no amounts were outstanding under the Canadian portion and \$64.4 million was outstanding under the U.S. portion of the \$125 million revolving credit facility due in April 2010. At November 30, 2008, the Company had approximately \$44.7 million available under the revolving credit facility after taking into account letters of credit issued totaling \$15.9 million.

Borrowings under the Company's senior secured credit facilities bear interest at the Company's choice of the Eurodollar rate or adjusted base rate ("ABR"), plus an applicable margin under either rate (ABR plus 3.75% on the revolving credit facility, all of Tranche E of the term loan facility, and a portion of Tranche A of the term loan facility, and Eurodollar rate plus 4.50% on a portion of Tranche A as of November 30, 2008). Weighted average interest rates at November 30, 2008 were 7.32% and 7.75% on Tranche A and Tranche E balances, respectively.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 9: Long Term Obligations (Continued)

The senior secured credit facilities are guaranteed by all of the Company's current and future domestic subsidiaries and are secured by substantially all of the assets of the Company and its current and future domestic subsidiaries by a first priority pledge of 100% of the capital stock of Sealy Mattress Company (the issuer of the debt and a 100% owned subsidiary of the Company through which all other subsidiaries are controlled), 100% of the capital stock of all other domestic subsidiaries, and a security interest in 65% of the capital stock of each direct foreign subsidiary of Sealy Mattress Company. The Company is the guarantor of these credit facilities.

The senior credit facilities are governed by the Senior Credit Agreement which imposes certain restrictions including, but not limited to, the payment of dividends or other equity distributions and the incurrence of debt or liens upon the assets of the Company or its subsidiaries. The Senior Credit Agreement also calls for the Company to maintain a maximum net leverage ratio and a minimum interest coverage ratio and imposes limitations on capital expenditures. These ratios were modified by the Second Amendment to the Third Amended and Restated Credit Agreement to make the required ratio covenants less restrictive. At November 30, 2008, the Company was in compliance with the covenants contained within its senior credit agreements. The Company is also required under this agreement to meet a minimum leverage ratio test in order to pay a dividend. The Company currently does not meet this requirement and therefore may not pay a dividend.

Interest Rate Agreements

On June 3, 2004, the Company entered into an interest rate swap agreement, effective July 6, 2004, effectively fixing the floating portion of the interest rate at 3.725% on \$200.0 million of the outstanding balance under the senior secured term loan through November 2005, declining to \$150.0 million through December 3, 2007. Concurrent with the Third Amended and Restated Credit Agreement, \$13.0 million of this swap was de-designated as a hedging instrument and a reduction of interest expense of \$0.2 million was recorded relating to this de-designation (see also Note 12).

On June 15, 2007, the Company entered into a new interest rate swap agreement, effective December 3, 2007, fixing the floating portion of the interest rate at 5.495% on \$242.0 million of the outstanding balance under the senior secured term loan through November 2008, declining to \$240.0 million from December 2008 through November 2009, and further declining to \$180.0 million from December 2009 through November 2010. The Company will select the Eurodollar rate on the hedged portion of the senior secured term loan during the term of the swap. The fair value of this swap instrument was a liability of \$15.9 million at November 30, 2008.

Additionally, the Company entered into three interest rate swaps for 2.3 million Euro, 2.9 million Euro, and 3.5 million Euro which fix the floating interest rate on the debt of its Europe segment at 4.92%, 4.85%, and 4.50%, respectively. The notional amounts of these contracts amortize over the life of the agreement and the agreements expire in May 2019, January 2013 and October 2013, respectively. The Company has not formally documented these interest rate swaps as hedges. Therefore, changes in the fair value of these interest rate swaps are recorded as a component of interest expense. The fair value of these swap instruments was a liability of \$0.4 million at November 30, 2008.

Senior Subordinated Notes

The outstanding 2014 Notes are publicly traded, registered securities and consist of a \$273.9 million aggregate principal amount maturing June 2014, bearing interest at 8.25% per annum payable semiannually in arrears on June 15 and December 15, commencing on December 15, 2004. The

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 9: Long Term Obligations (Continued)

2014 Notes rank junior to all of the Company's existing and future senior indebtedness and secured indebtedness, including any borrowings under the senior secured credit facilities. The 2014 Notes are guaranteed by all of the Company's domestic subsidiaries.

The 2014 Notes are governed by an indenture which calls for the Company to offer prepayment of the notes at a price equal to 101% of the outstanding principal amount in the event of a change in control as defined in the indenture. After June 15, 2009, the 2014 Notes are subject to redemption at 30 to 60 days' notice at the redemption prices (expressed as percentages of principal amount) set forth below, plus accrued and unpaid interest thereon and Special Interest, if any, to the applicable redemption date, if redeemed during the twelve month period beginning on June 15 of each of the years indicated below:

Year	Percentage of Principal Amount
2009	104.125%
2010	102.750%
2011	101.375%
2012 and thereafter	100.000%

The Company may also from time to time repurchase outstanding 2014 Notes on the open market for the purpose of retiring such notes as allowed under the restrictions provided by the Second Amendment to the Third Amended and Restated Credit Agreement. In connection with the IPO (Note 2), the Company used a portion of the proceeds from the offering to repurchase and retire \$47.5 million aggregate principal amount of the 2014 Notes in a series of open market transactions completed on April 26, 2006 at prices ranging from 105.25% to 105.92% of par, plus accrued interest. During the third and fourth quarters of fiscal 2007, the Company repurchased and retired \$68.1 million aggregate principal amount of the 2014 Notes on the open market at prices ranging from 98.0% to 100.0% of par, plus accrued interest. No such repurchases were made during fiscal 2008.

The indenture also imposes certain restrictions including, but not limited to, the payment of dividends or other equity distributions and the incurrence of debt or liens upon the assets of the Company or its subsidiaries. At November 30, 2008, the Company was in compliance with the covenants contained within the note indenture.

PIK Notes

On July 16, 2004, the Company issued \$75.0 million aggregate principal amount of senior subordinated pay-in-kind notes to certain institutional investors in transactions exempt from registration under the Securities Act of 1933. On April 21, 2006, the Company used approximately \$90.0 million of IPO proceeds to redeem the entire outstanding balance of the PIK Notes, along with accrued interest and prepayment penalties through the date of the redemption.

Other Information

The Company's net weighted average borrowing cost was 7.5% and 7.8% for fiscal 2008 and 2007, respectively. At November 30, 2008, the annual scheduled maturities of the principal amounts of long

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 9: Long Term Obligations (Continued)

term obligations are as follows (in thousands, and excluding future mandatory prepayments which may be required as discussed above):

2009	\$ 21,243
2010	143,012
2011	194,557
2012	110,545
2013	3,278
Thereafter	310,770
	<u>\$783,405</u>

The Company has entered into capital leases for the acquisition of machinery and equipment, computer hardware and software and a warehouse management system, all of which have been recorded in machinery and equipment in the Consolidated Balance Sheets. Amortization of the assets recorded under capital lease arrangements are recorded as a component of depreciation expense. Details of capitalized leased assets are as follows:

	<u>November 30, 2008</u>	<u>December 2, 2007</u>
	(in thousands)	
Machinery and equipment	\$ 5,375	\$ 4,280
Less: Accumulated depreciation	(3,293)	(1,607)
Net capitalized leased assets	<u>\$ 2,082</u>	<u>\$ 2,673</u>

Future minimum lease payments with the present value of the net minimum lease payments (included in other long term debt and current portion shown above) as of November 30, 2008 are as follows (in thousands):

Fiscal Year	
2009	\$ 936
2010	561
2011	184
2012	19
2013	4
Thereafter	—
Total minimum lease payments	<u>1,704</u>
Less: Amount representing interest	<u>(87)</u>
Present value of net minimum lease payments	<u>\$1,617</u>

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 10: Commitments

Leases

The Company leases certain operating facilities, offices and equipment. The following is a schedule of future minimum annual operating lease commitments at November 30, 2008.

<u>Fiscal Year</u>	<u>Commitments Under Operating Leases</u> (in thousands)
2009	\$ 13,571
2010	12,125
2011	9,658
2012	6,898
2013	4,536
Thereafter	15,759
	<u>\$ 62,547</u>

Rental expense charged to operations is as follows:

	<u>Year Ended Nov. 30, 2008</u>	<u>Year Ended Dec. 2, 2007</u>	<u>Year Ended Nov. 26, 2006</u>
	(in thousands)		
Minimum rentals	\$ 20,176	\$ 18,922	\$ 18,325
Contingent rentals (based upon delivery equipment mileage)	1,391	1,774	2,696
	<u>\$ 21,567</u>	<u>\$ 20,696</u>	<u>\$ 21,021</u>

The Company has the option to renew certain plant operating leases, with the longest renewal period extending through 2043. Most of the operating leases provide for increased rent through increases in general price levels. The Company recognizes rent expense in these situations on a straight-line basis over the lease term. Additionally, some of the leases provide for contingent rental payments based on the use of the leased assets or adjustments to future payments based on specified indices. Contingent payments directly related to the use of the assets and future adjustments of payments based on indices are expensed in the period in which the use of the asset occurs and are not included in the schedule of future minimum annual operating lease commitments.

Severance Obligations

The Company has employment agreements with certain of its executive officers and key employees which, among other things, provide severance benefits to those employees. During fiscal 2008, certain Executive Officers of the Company resigned. In accordance with their employment agreements and Company policy, certain benefits are to be paid to these Executive Officers in connection with their resignation. Additionally, during the year, the Company terminated other employees who were also entitled to severance benefits. In connection with the resignation of Executive Officers and the termination of the other employees, the Company recorded charges related to severance obligations due to these individuals. For fiscal 2008, severance costs of \$6.4 million were recorded as a component of operating income within the accompanying Consolidated Statements of Operations. These amounts are inclusive of the \$0.9 million of compensation cost that was recognized in connection with the

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 10: Commitments (Continued)

modification of the terms of the former Executive Officers' stock options made in connection with their resignation (Note 3). Severance benefits of \$3.2 million have been accrued as of November 30, 2008. Of this amount, \$2.2 million is included as a component of accrued compensation and \$1.0 million is included as a component of other noncurrent liabilities within the accompanying Consolidated Balance Sheet as of November 30, 2008.

Other Purchase Commitments

In connection with equipment ordered by the Company's components division related to a new product line, the Company has firm purchase commitments of approximately 1.1 million Swiss Francs (approximately \$0.9 million) outstanding at November 30, 2008.

Note 11: Fair Value of Financial Instruments

For assets and liabilities measured at fair value on a recurring basis during the period under the provisions of FAS 157, the Company uses an income approach to value the assets and liabilities for outstanding derivative contracts, which include interest rate swap and foreign currency forward contracts discussed in Note 12 below. These contracts are valued using an income approach which consists of a discounted cash flow model that takes into account the present value of future cash flows under the terms of the contracts using current market information as of the reporting date such as prevailing interest rates and foreign currency spot and forward rates. We mitigate derivative credit risk by transacting with highly rated counterparties. We have evaluated the credit and non-performance risks associated with our derivative counterparties and believe them to be insignificant at November 30, 2008. As noted in Note 1 above, the Company has adopted only the provisions of FAS 157 with respect to its financial assets and liabilities that are measured at fair value within the Condensed Consolidated Financial Statements. The Company has deferred the application of the provisions of this statement to its non-financial assets and liabilities in accordance with FSP 157-b. The following table provides a summary of the fair value of assets and liabilities under FAS 157 (in thousands):

	Fair Value Measurements at November 30, 2008 Using			
	November 30, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Derivatives	\$ (15,597)	\$ —	\$ (15,597)	\$ —

Due to the short maturity of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, their carrying values approximate fair value. The carrying amounts of long term debt under the senior secured credit facilities and the senior unsecured term loan approximate fair value because it was recently amended and because the interest rate adjusts to market interest rates. The fair value of long term debt under the 2014 Notes, based on a quoted market price, was \$161.6 million at November 30, 2008.

Note 12: Hedging Strategy

Use of hedging contracts allows the Company to reduce its overall exposure to interest rate and foreign currency exchange rate changes. The Company formally documents qualifying hedged transactions and hedging instruments, and assesses, both at inception of the contract and on an ongoing

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 12: Hedging Strategy (Continued)

basis, whether the hedging instruments are effective in offsetting changes in cash flows of the hedged transaction. The fair values of the interest rate and foreign currency agreements are estimated as described in Note 11 above, taking into consideration current interest rates and the current creditworthiness of the counterparties.

In June 2004, the Company entered into a swap agreement that has the effect of converting \$200 million of the floating-rate debt under the Company's senior credit facilities to a fixed rate basis, declining to \$150 million from December 2005 through December 3, 2007. The Company has formally designated this swap agreement as a cash flow hedge and expects the hedge to be highly effective in offsetting fluctuations in the designated interest payments resulting from changes in the benchmark interest rate. Effective August 25, 2006, the Company de-designated \$13 million of the interest rate swap for hedge accounting due to the amendment of the senior secured term loan agreement (Note 13). As a result of the de-designation, \$0.2 million previously recorded in accumulated other comprehensive income was recorded as a reduction of interest expense. The effective portion of changes in the market value of \$137 million of the swap is recorded in other comprehensive income and was amortized into interest expense over the remaining life of the interest rate swap agreement. For the years ended December 2, 2007 and November 26, 2006, \$2.5 million and \$1.8 million, respectively, were recorded as a reduction of interest expense, excluding the impact of the de-designation noted above.

On June 15, 2007, the Company entered into an interest rate swap agreement effective December 3, 2007 fixing the floating portion of the interest rate at 5.495% on \$242 million of the outstanding balance under the senior secured term loan through November 2008, declining to \$240 million from December 2008 through November 2009, and further declining to \$180 million from December 2009 through November 2010. The Company has formally designated this swap agreement as a cash flow hedge 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 Company will select the Eurodollar rate on the hedged portion of the senior secured term loan during the term of the swap. The fair value of this swap instrument was recorded in the Consolidated Balance Sheets as a liability of \$15.9 million and \$10.2 million at November 30, 2008 and December 2, 2007, respectively. Over the next 12 months, the Company expects to reclassify \$6.3 million of deferred losses from accumulated other comprehensive income to interest expense as related interest payments that are being hedged are recognized.

Additionally, the Company entered into three interest rate swaps for 2.3 million Euro, 2.9 million Euro, and 3.5 million Euro which fix the floating interest rate on the debt of its Europe segment at 4.92%, 4.85%, and 4.50%, respectively. The notional amounts of these contracts amortize over the life of the agreement and the agreements expire in May 2019, January 2013 and October 2013. The fair value of these swap instruments was an asset of \$0.4 million at November 30, 2008 and was recorded as a component of other noncurrent assets in the accompanying Consolidated Balance Sheets. We have not formally documented these interest rate swaps as hedges. Therefore, changes in the fair value of these interest rate swaps are recorded as a component of interest expense.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 12: Hedging Strategy (Continued)

At November 30, 2008 and December 2, 2007, the fair value carrying amount of the instruments indicated above was recorded as follows (in thousands):

	<u>November 30, 2008</u>	<u>December 2, 2007</u>
	(in thousands)	
Accrued interest receivable	\$ —	\$ 711
Other noncurrent assets	388	—
Accrued interest payable	(1,624)	—
Other current liabilities	(6,285)	(3,237)
Other liabilities	(8,055)	(7,006)
Total net liability	<u>\$ (15,576)</u>	<u>\$ (9,532)</u>

At November, 30, 2008 and December 2, 2007, accumulated other comprehensive income associated with the interest rate swaps was \$(8.9 million) and \$(6.3 million), respectively, net of income tax effects of \$5.4 million and \$3.9 million, respectively.

To protect against the reduction in value of forecasted foreign currency cash flows resulting from payments made in a foreign currency, the Company has instituted a forecasted cash flow hedging program. We hedge portions of our purchases denominated in foreign currencies and royalty payments to third parties with forward contracts. At November 30, 2008, the Company had five forward foreign currency contracts outstanding to purchase a total of \$2.5 million Euros with expiration dates ranging from December 31, 2008 through December 31, 2009. These hedges were entered into to protect against the fluctuation in the Euro denominated royalty payments related to a third party license held by the Company. The Company has formally designated these contracts as cash-flow hedges and they are expected to be highly effective in offsetting fluctuations in these royalty payments related to changes in the foreign currency exchange rates. The changes in fair value related to the effective portion of the hedge are recognized as a component of comprehensive income and will be reclassified into earnings as the royalty payments are made each quarter. At November 30, 2008, accumulated other comprehensive income associated with these forward contracts was an insignificant amount.

The Company also enters into forward foreign currency contracts that are not designated as hedges for accounting purposes. The changes in fair value of these foreign currency hedges are included as a part of selling, general and administrative expenses in the Consolidated Statements of Operations. At November 30, 2008, the fair value of the Company's net commitment under forward foreign currency contracts, which were all designated as hedges for accounting purposes, was a liability of an insignificant amount. At December 2, 2007, the Company did not have any foreign currency forward contracts outstanding.

Note 13: Debt Extinguishment and Refinancing Expenses

Debt extinguishment and refinancing expenses for the year ended November 30, 2008 include \$5.4 of refinancing expenses consisting of fees paid in connection with the Second Amendment to the Third Amended and Restated Credit Agreement in November 2008. (Note 9).

Debt extinguishment and refinancing expenses for the year ended December 2, 2007 include \$1.2 million of debt extinguishment costs consisting of \$1.7 million of non-cash charges offset by a \$0.5 million gain relating to the retirement of \$68.1 million of our 2014 Notes (Note 9).

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 13: Debt Extinguishment and Refinancing Expenses (Continued)

Debt extinguishment and refinancing expenses for the year ended November 26, 2006 include \$4.6 million of expense incurred in connection with the refinancing of the Company's senior secured credit agreement on August 25, 2006 (Note 9). Approximately \$4.1 million of this expense was a non-cash charge resulting from the write off of debt issuance costs. It also includes \$5.3 million of expense resulting from the extinguishment of debt retired with proceeds from the IPO (Note 2). Approximately \$1.7 million of this expense was a non-cash charge resulting from the write off of debt issuance costs associated with the retired debt.

Note 14: Other Income, Net

Other (income) expense, net includes interest income of \$0.4 million, \$0.4 million, and \$0.8 million for the years ended November 30, 2008, December 2, 2007, and November 26, 2006, respectively.

Note 15: Income Taxes

The Company and its domestic subsidiaries file a consolidated U.S. Federal income tax return. Income tax expense (benefit) consists of:

	Year Ended		
	November 30, 2008	December 2, 2007	November 26, 2006
	(in thousands)		
Current:			
Federal	\$ 2,237	\$ 21,951	\$ 19,698
International	11,962	16,272	14,201
State and local	(585)	2,042	1,648
	<u>13,614</u>	<u>40,265</u>	<u>35,547</u>
Deferred:			
Federal	6,193	(1,678)	1,442
International	(243)	(3,162)	34
State and local	2,367	(367)	553
	<u>8,317</u>	<u>(5,207)</u>	<u>2,029</u>
Total tax expense	<u>\$ 21,931</u>	<u>\$ 35,058</u>	<u>\$ 37,576</u>

Earnings before income taxes consisted of the following:

	Year Ended		
	November 30, 2008	December 2, 2007	November 26, 2006
	(in thousands)		
United States	\$ 20,396	\$ 80,036	\$ 77,143
International	(1,332)	34,395	34,687
	<u>\$ 19,064</u>	<u>\$ 114,431</u>	<u>\$ 111,830</u>

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 15: Income Taxes (Continued)

The differences between the actual tax expense and tax expense computed at the statutory U.S. Federal tax rate are explained as follows:

	Year Ended		
	November 30, 2008	December 2, 2007	November 26, 2006
	(in thousands)		
Income tax expense computed at statutory rates			
Federal income tax expense	\$ 6,673	\$ 40,052	\$ 39,140
State and local income taxes, net of federal tax benefit	1,999	1,815	1,943
Country mix impacts of foreign operations	(3,632)	73	703
Change in valuation allowance on deferred tax assets	6,365	(1,822)	(1,358)
Effect of non deductible meals and entertainment	455	709	602
Income tax reserve adjustments	962	(4,360)	(2,668)
Goodwill impairment	9,616	—	—
Other items, net	(507)	(1,409)	(786)
Total income tax expense	<u>\$ 21,931</u>	<u>\$ 35,058</u>	<u>\$ 37,576</u>

Income tax reserve adjustments result from a reduction in our income tax reserve as a result of the elimination of certain federal and state tax exposures during fiscal 2008 and 2007.

Deferred income taxes reflect the tax effect of temporary differences between carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The Company's total deferred tax assets and liabilities and their significant components are as follows:

	2008		2007	
	Current Asset (Liability)	Noncurrent Asset (Liability)	Current Asset (Liability)	Noncurrent Asset (Liability)
	(in thousands)			
Accrued salaries and benefits	\$ 4,052	\$ 8,381	\$ 6,093	\$ 9,999
Allowance for doubtful accounts	3,720	—	2,897	—
Plant shutdown, idle facilities, and environmental costs	289	885	45	927
Tax credit and loss carryforward benefit	591	33,682	162	26,139
Accrued warranty reserve	3,257	2,561	4,406	1,373
Other accrued reserves	406	—	1,379	—
Property, plant and equipment	445	(24,087)	(87)	(22,161)
Intangible assets	3,744	(6,892)	2,774	(7,294)
Debt financing costs	—	1,772	—	(251)
Prepaid advertising	—	(300)	—	(306)
Cash discounts	3,687	—	5,387	—
Inventory	1,428	—	1,414	—
All other	366	5,163	621	4,607
	<u>21,985</u>	<u>21,165</u>	<u>25,091</u>	<u>13,033</u>
Valuation allowance	(5,210)	(22,735)	(5,004)	(20,222)
	<u>\$ 16,775</u>	<u>\$ (1,570)</u>	<u>\$ 20,087</u>	<u>\$ (7,189)</u>

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 15: Income Taxes (Continued)

The fiscal 2008 and 2007 current and noncurrent deferred tax asset (liability), above, include amounts that are recorded in other current liabilities and noncurrent assets on the consolidated balance sheets, as appropriate.

The Company has a valuation allowance against certain deferred tax assets of \$27.9 million at November 30, 2008 and \$25.2 million at December 2, 2007, primarily reflecting uncertainties regarding utilization of loss carryforward benefits. \$3.2 million of the valuation allowance relates to net capital losses and reflects the uncertainty surrounding the Company's ability to generate sufficient capital gains to utilize all the losses. In fiscal 2007, the Company released \$2.5 million of valuation allowances related to deferred tax assets in Mexico that are expected to be utilized.

At November 30, 2008, the Company had unused state net operating loss and tax credit benefits of \$6.6 million generally expiring from 2009 through 2026. There is a valuation allowance against these benefits in the amount of \$6.6 million which represents the portion that the Company, at this time, expects to expire unused.

A provision has not been made for U.S. or foreign taxes on undistributed earnings of foreign subsidiaries considered indefinitely invested outside the United States. Should the Company repatriate foreign earnings, the Company would have to adjust the income tax provision in the period management determined that the Company would repatriate the earnings. The calculation of such additional taxes is not practicable.

The Company adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes", effective December 3, 2007. As a result of the adoption, the Company recognized a \$10.5 million net increase to the liability for uncertain tax positions including interest and penalties of \$0.7 million and \$2.5 million, respectively. These increases were accounted for as a cumulative effect adjustment and recognized as an increase in the beginning accumulated deficit in the Consolidated Balance Sheets.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Unrecognized tax benefits, December 2, 2007	\$25,877
Gross increases—tax positions taken in 2008	1,777
Gross decreases	—
Balance at November 30, 2008	<u>\$27,654</u>
Net change	<u>\$ 1,777</u>

As of November 30, 2008, \$13.9 million represents the amount of unrecognized tax benefits that, if recognized, would favorably impact the effective tax rate in future periods.

The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. During 2008, the Company recognized \$1.0 million interest and \$(0.2 million) penalties related to the unrecognized tax benefits noted above within the Consolidated Statements of Operations. The Consolidated Balance Sheets as of November 30, 2008 includes accrued interest of \$5.3 million and penalties of \$3.4 million due to unrecognized tax benefits.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 15: Income Taxes (Continued)

The Company expects the liability for uncertain tax positions to decrease by \$8.3 million within the succeeding twelve months due to expiration of income tax statute of limitations.

Significant judgment is required in evaluating the Company's federal, state and foreign tax positions and in the determination of its tax provision. Despite the Company's belief that its liability for unrecognized tax benefits is adequate, it is often difficult to predict the final outcome or the timing of the resolution of any particular tax matter. The Company may adjust these liabilities as relevant circumstances evolve, such as guidance from the relevant tax authority, or resolution of issues in the courts. These adjustments are recognized as a component of income tax expense entirely in the period in which they are identified. While the Company is currently undergoing examinations of certain of its corporate income tax returns by tax authorities, no issues related to these reserves have been presented to the Company and the Company has not been informed that such audits will result in an assessment or payment of taxes related to these positions during the one year period following November 30, 2008. The Company also cannot predict when or if any other future tax payments related to these tax positions may occur.

Federal years open to examination are fiscal year 2004 and forward. State and international jurisdictions remain open to examination for various years from fiscal year 2000 and forward.

Note 16: Retirement Plans

Defined Contribution Plans

Substantially all employees are covered by defined contribution profit sharing plans, where specific amounts (as annually established by the Company's board of directors) are set aside in trust for retirement benefits. Profit sharing expense was \$4.5 million, \$5.0 million, and \$6.1 million for the years ended November 30, 2008, December 2, 2007, and November 26, 2006, respectively.

Hourly employees working at ten of the Company's domestic manufacturing facilities are covered by union sponsored retirement plans. The Company's pension cost associated with these plans consists of periodic contributions to these plans based upon employee participation. The Company recognized expense for such contributions of \$4.7 million, \$5.3 million, and \$4.7 million, for the years ended November 30, 2008, December 2, 2007, and November 26, 2006, respectively.

Pension Plans

In September 2006, FAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FAS Statements No. 87, 88, 106 and 132(R)" ("FAS 158") was issued. The objectives of FAS 158 are for an employer to a) recognize the overfunded status of a plan as an asset and the underfunded status of a plan as a liability in the balance sheet and to recognize changes in the funded status in comprehensive income or loss, and b) measure the funded status of a plan as of the date of its balance sheet date. Additional minimum pension liabilities and related intangible assets are also derecognized upon adoption of the new standard. FAS 158 requires initial application of the requirement to measure plan assets and benefit obligations as of the end of fiscal years ending after December 15, 2006. FAS 158 requires initial application of the requirement to measure plan assets and benefit obligations as of the balance sheet date as of the end of fiscal years ending after December 15, 2008. The Company adopted part (a) of the statement as of December 2, 2007. The Company adopted part (b) of the statement as of November 30, 2008. The following table

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 16: Retirement Plans (Continued)

summarizes the effect of required changes in the additional minimum pension liabilities ("AML") as of December 2, 2007 prior to the adoption of FAS 158 as well as the impact of the initial adoption of FAS 158:

	Before application of FAS 158	Adjustments (in thousands)	After application of FAS 158
Accrued pension liability	\$ (7,447)	—	\$ (7,447)
Intangible asset	1,727	(1,727)	—
Deferred tax asset	2,158	699	2,857
Accumulated other comprehensive income, net of tax	3,426	1,028	4,454

The Company has a noncontributory, defined benefit pension plan covering current and former hourly employees at four of its active plants and eight previously closed U.S. facilities. Sealy Canada, Ltd. (a 100% 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. Pension plan assets consist of investments in various publicly traded stock, bond and money market mutual funds. The long-term rate of return for the plans is based on the weighted average of the plans' invested allocation and the historical returns for those asset categories. The long-term rate of return has been adjusted in the November 30, 2008 valuation to reflect the results of the slowdown of the global economy which has also caused an increase in the expected contribution levels for fiscal 2009. Because future compensation levels are not a factor in these plans' benefit formula, the accumulated benefit obligation is approximately equal to the projected benefit obligation as reported below. Sapsa Bedding, S.A.S. France (a 100% owned subsidiary of the Company) sponsors an unfunded indemnity plan which provides benefits to its employees. This plan does consider future compensation levels in the plan's benefit formula based on

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 16: Retirement Plans (Continued)

current inflation rates. The discount rate is based the returns on long-term bonds in the private sector and incorporates a long-term inflation rate. Summarized information for the plans follows:

	<u>2008</u>	<u>2007</u>
	(in thousands)	
Change in Benefit Obligation:		
Projected benefit obligation at beginning of year(a)	\$23,399	\$16,185
International defined benefit plans	—	4,622
Service cost	1,081	1,080
Interest cost	1,352	1,197
Plan changes	277	1,189
Actuarial losses	(3,238)	101
Curtailments	(14)	—
Changes in assumptions	(102)	(263)
Benefits paid	(902)	(514)
Expenses paid	(144)	(198)
Foreign currency exchange rate changes	(823)	—
Projected benefit obligation at end of year	<u>\$20,886</u>	<u>\$23,399</u>
Change in Plan Assets:		
Fair value of plan assets at beginning of year	\$15,952	\$12,474
International defined benefit plans	—	1,111
Actual return on assets	(5,151)	934
Employer contribution	2,165	2,092
Benefits paid	(902)	(461)
Expenses paid	(144)	(198)
Foreign currency exchange rate changes	(247)	—
Fair value of plan assets at end of year	<u>\$11,673</u>	<u>\$15,952</u>
Funded Status of Plan:		
Funded status	\$ (9,213)	\$ (7,447)
Unrecognized actuarial loss	7,463	4,442
Unrecognized transition asset	—	(87)
Unrecognized prior service cost	2,515	2,956
Net amount recognized as of fiscal year end	<u>\$ 765</u>	<u>\$ (136)</u>

(a) Measurement date is November 30 of each year.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 16: Retirement Plans (Continued)

	2008	2007
	(in thousands)	
Amounts Recognized in the Consolidated Balance Sheets:		
Accrued benefit liability	\$ (9,213)	\$ (7,447)
Accumulated other comprehensive income, pre-tax	9,978	7,311
Net amount recognized as of fiscal year end	<u>\$ 765</u>	<u>\$ (136)</u>
Accumulated Benefit Obligation and Fair Value of Assets:		
Accumulated benefit obligation	\$ (20,886)	\$ (23,399)
Projected benefit obligation	(20,886)	(23,399)
Fair value of assets	11,673	15,952
Unfunded Projected Benefit Obligation	<u>\$ (9,213)</u>	<u>\$ (7,447)</u>

	2008	2007
	(in thousands)	
Amounts Recognized in Accumulated Other Comprehensive Income:		
Net actuarial loss	\$ 7,463	\$ 4,442
Prior service costs	2,515	2,956
Transition asset	—	(87)
Net amount recognized as of fiscal year end	<u>\$ 9,978</u>	<u>\$ 7,311</u>

	2008 Target	2008 Actual	2007 Actual
Allocation of plan assets:			
Equity securities	60.00%	60.86%	59.72%
Debt securities	40.00%	38.37%	39.74%
Other	—	0.78%	0.54%
Total plan assets	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

	2008	2007	2006
	(in thousands)		
Components of Net Periodic Pension Cost:			
Service cost	\$ 1,081	\$ 1,080	\$ 590
Interest cost	1,352	1,197	828
Expected return on assets	(1,333)	(1,161)	(874)
Curtailement loss	219	—	—
Amortization of unrecognized net loss	157	169	119
Amortization of unrecognized transition asset	(87)	(87)	(87)
Amortization of unrecognized prior service cost	276	226	198
Net periodic pension cost	<u>\$ 1,667</u>	<u>\$ 1,424</u>	<u>\$ 774</u>

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 16: Retirement Plans (Continued)

	2008	2007	2006
	(in thousands)		
Other changes in plan assets and benefit obligations recognized in other comprehensive income:			
Net actuarial loss (gain)	\$ 3,141	\$ 278	\$ (71)
Prior service cost	276	1,020	—
Effect of curtailment(a)	(233)	—	—
Amortization of prior service cost	(276)	(226)	(198)
Amortization of net loss	(157)	(169)	(119)
Amortization of transition obligation	87	87	87
Total recognized in other comprehensive income	<u>\$ 2,838</u>	<u>\$ 990</u>	<u>\$ (301)</u>

(a) This curtailment loss relates to the closure of our Clarion, Pennsylvania manufacturing facility. See Note 23.

	2008	2007	2006
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate(a)	6.78%	5.82%	6.00%
Expected long term return on plan assets	6.64%	6.79%	8.25%
Weighted average rate of increase in future compensation levels	0.40%	0.37%	N/A

(a) Due to current economic differences in the interest rates in the jurisdictions of the retirement plans, the discount rates used to determine the benefit obligations for the United States retirement plans, Canadian retirement plans and the French indemnity plan were 7.00%, 7.25% and 5.50%, respectively.

Amounts in accumulated other comprehensive income expected to be recognized in net periodic benefit cost in 2009 (in thousands):

Amortization of net actuarial loss	\$ 380
Amortization of prior service cost	246

Estimated Future Benefit Payments (in thousands):	
Fiscal 2009	\$ 471
Fiscal 2010	848
Fiscal 2011	543
Fiscal 2012	717
Fiscal 2013	996
Fiscal 2014-2018	6,606
Employer Contributions Expected to be Paid in Fiscal 2009	\$ 1,209

Other Employee Benefit Plans

Employees of Sapsa Bedding, Srl Italy (a 100% owned subsidiary of the Company) participate in an employee severance indemnity plan as required by Italian labor legislation. The Company has recognized a liability of \$1.5 million and \$1.7 million as of November 30, 2008 and December 2, 2007, respectively, related to this plan which has been recorded as a component of other non-current

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 16: Retirement Plans (Continued)

liabilities in the accompanying consolidated balance sheets. This liability is required to be settled to retiring employees and is to be partially paid in advance if certain conditions are met. Benefits paid under this plan were \$0.2 million, \$0.2 million, and \$0.2 million in fiscal 2008, 2007, and 2006, respectively.

Note 17: Summary of Interim Financial Information (Unaudited)

Quarterly financial data for the years ended November 30, 2008 and December 2, 2007, is presented below:

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
(Amounts in thousands, except for share and per share data)				
2008:				
Net sales	\$ 391,929	\$ 375,375	\$ 404,963	\$ 325,756
Gross profit	153,195	148,343	164,120	118,383
Net income	16,214	11,957	10,942	(41,980)
Earnings per share—Basic	0.18	0.13	0.12	(0.46)
Earnings per share—Diluted	0.17	0.13	0.12	(0.46)
2007:				
Net sales	\$ 412,567	\$ 401,828	\$ 446,380	\$ 441,290
Gross profit	177,274	172,518	179,888	179,930
Net income	24,634	16,133	21,471	17,135
Earnings per share—Basic	0.27	0.18	0.23	0.19
Earnings per share—Diluted	0.26	0.17	0.22	0.18

The results of the second quarter of fiscal 2008 include an increase in net income of \$3.8 million net of taxes, due to a change in the estimate of our liability related to warranty and other product returns (See Note 4). The results of the fourth quarter of fiscal 2008 include significant charges related to the following: 1) A \$27.5 million goodwill impairment loss was recognized due to impairment identified at the Company's Puerto Rico and Europe reporting units (See Note 8); 2) \$5.4 million of refinancing expenses were recognized in the fourth quarter associated with the Second Amendment to the Third Amended and Restated Credit Agreement (See Note 9).

Note 18: Contingencies

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. The Company 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, the Company 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 and its subsidiary retained primary responsibility for the required remediation. The Company has completed essentially all soil remediation with the New Jersey Department of Environmental Protection approval and operates 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. The Company has recorded a reserve as a component of other

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 18: Contingencies (Continued)

accrued expenses and other noncurrent liabilities in the accompanying Consolidated Balance Sheets as of November 30, 2008 for \$2.8 million (\$3.7 million prior to discounting at 4.75%) associated with this remediation project. Also in connection with this site, the Company received a written complaint from the New Jersey Department of Environmental Protection alleging natural resources damages in an unspecified amount. In November 2008, the trial court in this matter granted the Company's summary judgment motion and the time to appeal this ruling has passed.

The Company is also remediating 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 Environmental Protection approval of the remediation plan. The Company has completed essentially all soil remediation under the remediation plan and is currently monitoring groundwater at the site. The Company identified cadmium in the ground water at the site and removed the contaminated soil and rock from the site during fiscal 2007. The Company has recorded a liability of approximately \$0.2 million associated with the additional work and ongoing monitoring. The Company believes the contamination is attributable to the manufacturing operations of previous unaffiliated occupants of the facility.

The Company removed three underground storage tanks previously used for diesel, gasoline, and waste oil from its South Gate, California facility in March 1994 and remediated the soil in the area. Since August 1998, the Company has been working with the California Regional Water Quality Control Board, Los Angeles Region to monitor ground water at the site. Subsequent to fiscal year end, on December 1, 2008, the Company sold this facility and the buyer assumed responsibility for the environmental issues related to the site (Note 24).

While 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 adverse 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 adverse effect.

On October 12, 2006, the Canadian government passed legislation providing for tariff refunds on certain purchases of wood made by the Company from 2002 through 2005. During the second quarter of fiscal 2007, certain factors on which the refund was contingent were resolved; thus, the Company recorded \$2.5 million of refunds in the second quarter of fiscal 2007 as a reduction of costs of goods sold in the Consolidated Statements of Operations.

Note 19: Segment Information

The Company has determined that it has two reportable segments: the Americas and Europe. These segments have been identified and aggregated based on the Company's organizational structure which is organized around geographic areas.

Both reportable segments manufacture and market conventional bedding. The Americas segment's operations are concentrated in the United States, Canada, Mexico, Argentina, Brazil and Puerto Rico. Europe's operations are concentrated in western Europe. The accounting policies of the segments are the same as those described in Note 1. The Company evaluates performance based on profit or loss from operations before interest expense, income taxes, depreciation and amortization ("EBITDA"). The Company accounts for inter-segment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 19: Segment Information (Continued)

In fiscal 2008, one customer represented approximately 10.3% of sales of the Americas segment. In fiscal 2007 and 2006, no one customer represented more than 10% of sales within the Americas segment. One customer represented approximately 30.2% of sales and 11.6% of sales within the Europe segment in fiscal 2008 and fiscal 2007, respectively. In fiscal 2006, no one customer represented 10% or more of total net sales within the Europe segment. Long lived assets (principally property, plant and equipment) outside the United States were \$60.8 million and \$68.6 million, as of November 30, 2008 and December 2, 2007, respectively.

Sales to external customers by geographic area are as follows:

	Fiscal year		
	2008	2007	2006
Americas:			
United States	\$ 1,055,682	\$ 1,266,355	\$ 1,209,012
Canada	187,672	196,264	167,763
Other International	105,929	99,120	84,197
Total Americas	1,349,283	1,561,739	1,460,972
Europe	148,740	140,326	121,871
Total	\$ 1,498,023	\$ 1,702,065	\$ 1,582,843
Total International	\$ 442,341	\$ 435,710	\$ 373,831

Sales from Europe to the Americas were \$3.6 million, \$9.3 million and \$9.0 million during fiscal 2008, 2007 and 2006, respectively. The decrease in the level of sales in fiscal 2008 as compared with prior years is due to the completion of the Company's Mountain Top, Pennsylvania manufacturing facility which now supplies latex components to the Company's domestic operations. In fiscal 2007 and 2006, these latex components used in domestic production were sourced from the Europe segment.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 19: Segment Information (Continued)

Segment information for the fiscal years 2008, 2007, and 2006 is presented below:

	Year Ended		
	November 30, 2008	December 2, 2007	November 26, 2006
	(in thousands)		
Net sales to external customers:			
Americas	\$ 1,349,283	\$ 1,561,739	\$ 1,460,972
Europe	148,740	140,326	121,871
	<u>1,498,023</u>	<u>1,702,065</u>	<u>1,582,843</u>
Capital expenditures:			
Americas	22,794	35,099	25,384
Europe	2,181	7,335	5,488
	<u>24,975</u>	<u>42,434</u>	<u>30,872</u>
Total assets:			
Americas	852,644	902,986	894,628
Europe	69,784	122,630	109,345
Intersegment eliminations	(1,554)	(537)	(1,241)
	<u>920,874</u>	<u>1,025,079</u>	<u>1,002,732</u>
EBITDA:			
Americas	140,567	206,894	210,493
Europe	(27,364)	1,302	5,468
Inter-segment eliminations	279	704	(1,985)
	<u>113,482</u>	<u>208,900</u>	<u>213,976</u>
Reconciliation of EBITDA to net income (loss):			
EBITDA from segments	113,482	208,900	213,976
Interest expense	60,464	63,976	71,961
Income taxes	21,931	35,058	37,576
Depreciation and amortization	33,954	30,493	30,185
Cumulative effect of change in accounting principle	—	—	287
Net Income (Loss)	<u>\$ (2,867)</u>	<u>\$ 79,373</u>	<u>\$ 73,967</u>

Note 20: Related Party Transactions

During fiscal 2008, the Company was billed for premiums of \$0.2 million for excess directors and officers liability insurance and excess liability insurance by KKR. Additionally, the Company incurred costs of \$2.6 million for consulting services provided by Capstone Consulting LLC, a consulting company that works exclusively with KKR's portfolio companies. Further, the Company was billed for \$0.6 million of executive search costs performed by KKR. As of November 30, 2008, \$2.4 million of these amounts was accrued as a component of other accounts payable and accrued expenses in the accompanying Consolidated Balance Sheets.

During fiscal 2007, the Company paid premiums of \$0.1 million for excess directors and officers liability insurance and excess liability insurance to KKR.

In fiscal 2006, the Company used \$11.0 million of IPO proceeds to pay KKR a termination fee to end the Management Services Agreement between the Company and KKR. As a result these fees are no longer being paid starting in April 2006. During the fiscal year November 26, 2006, the Company paid management fees of \$0.8 million to KKR.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 21: Common Stock and Options Subject to Redemption

In connection with its adoption of FAS 123(R), the Company reclassified as temporary equity amounts previously included in additional paid in capital that are associated with outstanding shares and options which, under the terms of management shareholder agreements, are potentially redeemable for a 180 day period following the death or disability of the share or option holder. As discussed in Note 3, due to the expiration of a right of certain officers of the Company to sell their shares of stock in Sealy Corporation back to the Company upon their retirement, \$1.5 million of previously recognized liability was reclassified to temporary equity during fiscal 2008. At November 30, 2008, such temporary equity of \$8.9 million consisted of \$0.7 million related to 282,400 shares of Class A common stock held by members of management, and \$8.1 million associated with 1,443,865 vested equity share Rollover Options held by members of management for which the Company recognized compensation expense in fiscal 2004 recapitalization. At December 2, 2007, such temporary equity of \$16.2 million consisted of \$1.5 million related to 401,288 shares of Class A common stock held by members of management, and \$14.7 million associated with 2,907,136 vested equity share Rollover Options held by members of management for which the Company recognized compensation expense in fiscal 2004 recapitalization.

Note 22: Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(in thousands)		
Numerator:			
Net income (loss) before cumulative effect of a change in accounting principle	\$ (2,867)	\$ 79,373	\$ 74,254
Cumulative effect of a change in accounting principle	—	—	(287)
Net income (loss) available to common shareholders	<u>\$ (2,867)</u>	<u>\$ 79,373</u>	<u>\$ 73,967</u>
Denominator:			
Denominator for basic earnings per share—weighted average shares	91,231	91,299	83,622
Effect of dilutive securities:			
Stock options	—	4,971	5,893
Other	—	67	43
Denominator for diluted earnings per share—adjusted weighted average shares and assumed conversions	<u>91,231</u>	<u>96,337</u>	<u>89,558</u>

Since the Company reported a net loss for the period ending November 30, 2008, the 12,331 outstanding options to purchase common stock, restricted shares and share units outstanding are considered antidilutive and are not included in the calculation of diluted earnings per share. Options and share units not included in the calculation of diluted earnings per share because their impact is antidilutive (in thousands) are 1,478 and 1,938 for fiscal years 2007, and 2006, respectively.

As of November 30, 2008, December 2, 2007, and November 26, 2006, the Company's capital stock consists of voting Class A common stock, par value \$0.01 per share ("Class A Common"). The Board of Directors of the Company is authorized to issue preferred stock, par value \$0.01 per share, with such designations and other terms as may be stated in the resolutions providing for the issue of any such preferred stock adopted from time to time by the Board of Directors.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 22: Earnings Per Share (Continued)

On February 19, 2007, the Board of Directors approved a share repurchase program authorizing the Company to repurchase up to \$100 million of the Company's common stock. The Company has repurchased \$16.3 million under this program as of November 30, 2008, all of which were repurchased in fiscal 2007.

Note 23: Restructuring Activities

During fiscal 2008, the Company recognized restructuring charges related to several initiatives, including facility closures and organizational changes. The pretax restructuring charges recognized by the Company during fiscal 2008, 2007 and 2006 were as follows:

	<u>November 30, 2008</u>	<u>December 2, 2007</u>	<u>November 26, 2006</u>
		(in thousands)	
Americas Segment	\$ 2,912	\$ —	\$ —
Europe Segment	214	—	—
	<u>\$ 3,126</u>	<u>\$ —</u>	<u>\$ —</u>

The following table summarizes the restructuring activity for fiscal 2008, and the related restructuring liabilities balance (included as a component of other accrued liabilities within the accompanying Consolidated Balance Sheets) as of November 30, 2008 and December 2, 2007:

	<u>2008 Restructuring Activities</u>				<u>Liabilities November 30, 2008</u>
	<u>Liabilities December 2, 2007</u>	<u>Charges to Expense</u>	<u>Cash Payments</u>	<u>Non-cash Utilized</u>	
					(in thousands)
Severance and employee benefits	\$ —	\$ 2,253	\$ (1,860)	\$ —	\$ 393
Asset impairment charges	—	873	—	(873)	—
Other restructuring costs	—	—	—	—	—
Total	<u>\$ —</u>	<u>\$ 3,126</u>	<u>\$ (1,860)</u>	<u>\$ (873)</u>	<u>\$ 393</u>

In the first quarter of fiscal 2008, management made the decision to cut back the manufacturing operations in Brazil and move to a business model under which significantly more product will be supplied by production from other Sealy manufacturing facilities. As a result, the Company incurred charges of \$0.5 million related to employee severance and related benefits. The plan was completed in the fourth quarter of fiscal 2008.

In the third quarter of fiscal 2008, management elected to close its administrative offices near Milan, Italy and relocate these activities to its manufacturing facility in Silvano, Italy. This closure resulted in the elimination of approximately 10 employees who elected not to relocate in the fourth quarter of fiscal 2008. The Company recorded a pre-tax restructuring charge related to this action of \$0.2 million during the year ended November 30, 2008, the majority of which was related to employee severance and benefits. An insignificant amount of this charge was related to relocation costs. This plan was completed in the fourth quarter of fiscal 2008.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 23: Restructuring Activities (Continued)

In the third quarter of fiscal 2008, management also made the decision to close its manufacturing facility in Clarion, Pennsylvania. This facility was closed on October 17, 2008. This closure resulted in the elimination of approximately 114 positions, the majority of which occurred in the fourth quarter of fiscal 2008. We recorded a pre-tax restructuring and impairment charge related to this action of \$2.5 million during fiscal 2008, of which \$1.6 million was related to employee severance and benefits and other exit costs, and \$0.9 million which was non-cash in nature, related to fixed asset impairment charges. The impairment charges were recognized based on the difference between the carrying value and the amount expected to be recovered through sale of the property, plant and equipment. The Company expects to incur additional restructuring charges related to this activity of approximately \$0.1 million to \$0.2 million, principally in the form of relocation costs, which are expected to be recorded in first quarter of fiscal 2009, after which time the plan should be complete.

The accrued balance related to these restructuring activities as of November 30, 2008 is \$0.4 million and is recorded as a component of other accrued expenses in the accompanying Consolidated Balance Sheet. No amounts were accrued as of December 2, 2007.

Note 24: Subsequent Events

On December 1, 2008, the Company entered into two interest rate swap agreements effective December 4, 2008. The first of these swaps fixes the floating portion of the interest rate at 1.952% on \$20.0 million of the outstanding balance under the senior credit facility through November 4, 2009. The second of these swaps fixes the floating portion of the interest rate at 1.991% on \$107.0 million of the outstanding balance under the senior credit facility through February 4, 2010. The Company has formally designated these swap agreements as cash flow hedges and expects the hedges to be highly effective in offsetting fluctuations in the designated interest payments resulting from changes in the benchmark interest rate. The Company will select the Eurodollar rate on the hedged portion of the senior credit facility during the term of these swaps.

On December 1, 2008, the Company sold fifty percent of its ownership interest in its 100% owned subsidiary Sealy Korea Company to the Company's Australian licensee and these operations became part of the joint venture that we participate in with the Australian licensee. In consideration of the sale of the fifty percent interest, the Company received \$1.4 million. Upon the close of this transaction, the subsidiary was deconsolidated and will be recognized prospectively as an equity method investee.

On December 1, 2008, the Company completed a sale-leaseback transaction of its Southgate, California facility, including the land, building and improvements affixed to the properties. The facility is being leased back over a 7 year term and is classified as an operating lease. The net proceeds from the sale were \$8.6 million, resulting in a gain on the sale of approximately \$4.9 million. The gain on the sale of this facility will be deferred and amortized over the lease term. As indicated in Note 18, the buyer of the Southgate property assumed responsibility for the environmental issues related to the site.

On December 4, 2008, the Company acquired a 50% interest in a joint venture with our Australian licensee which owns the assets of its New Zealand licensee. The purchase price for the 50% ownership was \$1.9 million. Additional contributions of \$0.4 million were made by each party to the joint venture to fund the initial working capital of this entity. The Company will recognize this joint venture in future periods as an equity method investee within its consolidated financial statements.

SEALY CORPORATION

Notes To Consolidated Financial Statements (Continued)

Note 25: Guarantor/Non-Guarantor Financial Information

Sealy Corporation, Sealy Mattress Corporation (a 100% owned subsidiary of Sealy Corporation) and each of the subsidiaries of Sealy Mattress Company (the "Issuer") that guarantee the 2014 Notes (as defined below) and are 100% owned subsidiaries of the Issuer, (the "Guarantor Subsidiaries") have fully and unconditionally guaranteed, on a joint and several basis, the obligation to pay principal and interest with respect to the 8.25% Senior Subordinated Notes due in 2014 (the "2014 Notes") of the Issuer. Substantially all of the Issuer's operating income and cash flow is generated by its subsidiaries. As a result, funds necessary to meet the Issuer's debt service obligations are provided in part by distributions or advances from its subsidiaries. Under certain circumstances, contractual and legal restrictions, as well as the financial condition and operating requirements of the Issuer's subsidiaries, could limit the Issuer's ability to obtain cash from its subsidiaries for the purpose of meeting its debt service obligations, including the payment of principal and interest on the 2014 Notes. Although holders of the 2014 Notes will be direct creditors of the Issuer's principal direct subsidiaries by virtue of the guarantees, the Issuer has subsidiaries ("Non-Guarantor Subsidiaries") that are not included among the Guarantor Subsidiaries, and such subsidiaries will not be obligated with respect to the 2014 Notes. As a result, the claims of creditors of the Non-Guarantor Subsidiaries will effectively have priority with respect to the assets and earnings of such companies over the claims of creditors of the Issuer, including the holders of the 2014 Notes.

The following supplemental condensed consolidating financial statements present:

1. Condensed consolidating balance sheets as of November 30, 2008 and December 2, 2007 and condensed consolidating statements of operations and cash flows for the fiscal years ended November 30, 2008, December 2, 2007, and November 26, 2006.
2. Sealy Corporation (as "Guarantor Parent"), Sealy Mattress Corporation (a guarantor), the Issuer, combined Guarantor Subsidiaries and combined Non-Guarantor Subsidiaries with their investments in subsidiaries accounted for using the equity method (see Note 1).
3. Elimination entries necessary to consolidate the Guarantor Parent and all of its subsidiaries.

Separate financial statements of each of the Guarantor Subsidiaries are not presented because management believes that these financial statements would not be material to investors.

Sealy Corporation has not received cash dividends from any of its subsidiaries during the fiscal years ended November 30, 2008, December 2, 2007, and November 26, 2006.

SEALY CORPORATION

Supplemental Condensed Consolidating Balance Sheets

November 30, 2008

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets							
Current assets:							
Cash and cash equivalents	\$ 589	\$ —	\$ 1	\$ 2,423	\$ 23,583	\$ —	\$ 26,596
Accounts receivable, net	—	—	7	80,528	76,048	—	156,583
Inventories	—	—	1,695	44,454	18,945	(460)	64,634
Prepaid expenses, deferred income taxes and other current assets	1,368	—	2,645	38,406	5,325	—	47,744
	1,957	—	4,348	165,811	123,901	(460)	295,557
Property, plant and equipment, at cost	—	—	9,676	352,888	86,744	—	449,308
Less accumulated depreciation	—	—	(4,613)	(180,256)	(33,691)	—	(218,560)
	—	—	5,063	172,632	53,053	—	230,748
Other assets:							
Goodwill	—	—	24,741	301,942	30,466	—	357,149
Other intangibles, net	2,989	—	—	1,956	—	—	4,945
Net investment in subsidiaries	(199,388)	216,613	367,163	29,866	—	(414,254)	—
Due from (to) affiliates	43,933	(416,001)	534,520	(72,344)	(90,206)	98	—
Debt issuance costs, net and other assets	—	—	8,640	17,088	6,747	—	32,475
	(152,466)	(199,388)	935,064	278,508	(52,993)	(414,156)	394,569
Total assets	\$ (150,509)	\$ (199,388)	\$ 944,475	\$ 616,951	\$ 123,961	\$ (414,616)	\$ 920,874
Liabilities and Stockholders' (Deficit)							
Equity							
Current liabilities:							
Current portion—long-term obligations	\$ —	\$ —	\$ 3,750	\$ 2,737	\$ 14,756	\$ —	\$ 21,243
Accounts payable	—	—	341	52,337	44,406	—	97,084
Accrued customer incentives and advertising	—	—	—	24,013	10,529	—	34,542
Accrued compensation	—	—	392	16,082	8,323	—	24,797
Accrued interest	27	—	1,127	14,919	359	—	16,432
Other accrued expenses	3,702	—	6,408	27,560	6,693	—	44,363
	3,729	—	12,018	137,648	85,066	—	238,461
Long-term obligations	—	—	711,776	42,034	8,352	—	762,162
Other noncurrent liabilities	947	—	8,055	51,280	10,975	—	71,257
Deferred income taxes	783	—	(3,987)	3,443	4,723	—	4,962
Common stock and options subject to redemption	8,856	—	—	—	—	—	8,856
Stockholders' equity (deficit)	(164,824)	(199,388)	216,613	382,546	14,845	(414,616)	(164,824)
Total liabilities and stockholders' equity (deficit)	\$ (150,509)	\$ (199,388)	\$ 944,475	\$ 616,951	\$ 123,961	\$ (414,616)	\$ 920,874

SEALY CORPORATION

Supplemental Condensed Consolidating Balance Sheets

December 2, 2007

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets							
Current assets:							
Cash and cash equivalents	\$ 4	\$ —	\$ 1	\$ 4,012	\$ 10,590	\$ —	\$ 14,607
Accounts receivable, net	29	—	720	101,675	106,397	—	208,821
Inventories	—	—	1,483	49,841	23,200	(842)	73,682
Prepaid expenses, deferred income taxes and other current assets	1,458	—	1,693	38,568	4,865	—	46,584
	<u>1,491</u>	<u>—</u>	<u>3,897</u>	<u>194,096</u>	<u>145,052</u>	<u>(842)</u>	<u>343,694</u>
Property, plant and equipment, at cost	—	—	9,051	336,196	97,059	—	442,306
Less accumulated depreciation	—	—	(3,685)	(160,839)	(33,910)	—	(198,434)
	<u>—</u>	<u>—</u>	<u>5,366</u>	<u>175,357</u>	<u>63,149</u>	<u>—</u>	<u>243,872</u>
Other assets:							
Goodwill	—	—	24,741	304,773	65,946	—	395,460
Other intangibles, net	6,622	—	—	2,244	—	—	8,866
Net investment in subsidiaries	(151,637)	264,066	413,585	46,521	—	(572,535)	—
Due from (to) affiliates	40,091	(415,703)	535,242	(63,875)	(95,954)	199	—
Debt issuance costs, net and other assets	—	—	10,935	17,869	4,383	—	33,187
	<u>(104,924)</u>	<u>(151,637)</u>	<u>984,503</u>	<u>307,532</u>	<u>(25,625)</u>	<u>(572,336)</u>	<u>437,513</u>
Total assets	<u>\$ (103,433)</u>	<u>\$ (151,637)</u>	<u>\$ 993,766</u>	<u>\$ 676,985</u>	<u>\$ 182,576</u>	<u>\$ (573,178)</u>	<u>\$ 1,025,079</u>
Liabilities and Stockholders' (Deficit)							
Equity							
Current liabilities:							
Current portion—long-term obligations	\$ —	\$ —	\$ 15,000	\$ 3,323	\$ 18,110	\$ —	\$ 36,433
Accounts payable	—	—	508	77,009	57,835	—	135,352
Accrued customer incentives and advertising	—	—	—	36,949	10,805	—	47,754
Accrued compensation	—	—	420	21,210	10,792	—	32,422
Accrued interest	56	—	1,040	15,216	214	—	16,526
Other accrued expenses	3,931	—	3,431	39,019	7,017	—	53,398
	<u>3,987</u>	<u>—</u>	<u>20,399</u>	<u>192,726</u>	<u>104,773</u>	<u>—</u>	<u>321,885</u>
Long-term obligations	—	—	703,938	41,517	11,867	—	757,322
Other noncurrent liabilities	5,356	—	7,006	25,483	12,969	—	50,814
Deferred income taxes	461	—	(1,643)	3,479	5,998	—	8,295
Common stock and options subject to redemption	16,156	—	—	—	—	—	16,156
Stockholders' equity (deficit)	<u>(129,393)</u>	<u>(151,637)</u>	<u>264,066</u>	<u>413,780</u>	<u>46,969</u>	<u>(573,178)</u>	<u>(129,393)</u>
Total liabilities and stockholders' equity (deficit)	<u>\$ (103,433)</u>	<u>\$ (151,637)</u>	<u>\$ 993,766</u>	<u>\$ 676,985</u>	<u>\$ 182,576</u>	<u>\$ (573,178)</u>	<u>\$ 1,025,079</u>

SEALY CORPORATION

Supplemental Condensed Consolidating Statements of Operations

Year Ended November 30, 2008

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$ —	\$ —	\$ 74,171	\$ 1,012,557	\$ 439,213	\$ (27,918)	\$ 1,498,023
Cost and expenses:							
Cost of goods sold	—	—	44,155	611,451	286,675	(28,299)	913,982
Selling, general and administrative	376	—	7,198	360,121	114,871	—	482,566
Goodwill impairment loss	—	—	—	2,831	24,644	—	27,475
Amortization of intangibles	3,232	—	—	289	171	—	3,692
Restructuring and related costs	—	—	—	2,464	662	—	3,126
Royalty (income) expense, net	(4,405)	—	—	(17,323)	4,401	—	(17,327)
Income from operations	797	—	22,818	52,724	7,789	381	84,509
Interest expense	257	468	53,660	2,264	3,815	—	60,464
Other (income) expense, net	—	—	5,378	(50)	(347)	—	4,981
Loss (income) from equity investees	7,948	7,650	9,157	—	—	(24,755)	—
Loss (income) from non-guarantor equity investees	—	—	—	4,190	—	(4,190)	—
Capital charge and intercompany interest allocation	(468)	—	(35,652)	32,013	4,107	—	—
Income (loss) before income taxes	(6,940)	(8,118)	(9,725)	14,307	214	29,326	19,064
Income tax expense (benefit)	(4,073)	(170)	(2,075)	23,466	4,683	100	21,931
Net income (loss)	\$ (2,867)	\$ (7,948)	\$ (7,650)	\$ (9,159)	\$ (4,469)	\$ 29,226	\$ (2,867)

SEALY CORPORATION

Supplemental Condensed Consolidating Statements of Operations

Year Ended December 2, 2007

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$ —	\$ —	\$ 81,005	\$ 1,221,730	\$ 434,968	\$ (35,638)	\$ 1,702,065
Cost and expenses:							
Cost of goods sold	—	—	47,519	704,449	276,705	(36,218)	992,455
Selling, general and administrative	136	—	7,714	426,036	111,722	—	545,608
Amortization of intangibles	2,947	—	—	289	120	—	3,356
Royalty (income) expense, net	(3,699)	—	—	(18,178)	3,315	—	(18,562)
Income from operations	616	—	25,772	109,134	43,106	580	179,208
Interest expense	354	624	57,824	1,193	3,981	—	63,976
Other (income) expense, net	(8)	—	1,222	(47)	(366)	—	801
Loss (income) from equity investees	(76,331)	(76,331)	(74,806)	—	—	227,468	—
Loss (income) from non- guarantor equity investees	—	—	—	(22,132)	—	22,132	—
Capital charge and intercompany interest allocation	1	(624)	(35,805)	29,144	7,284	—	—
Income (loss) before income taxes	76,600	76,331	77,337	100,976	32,207	(249,020)	114,431
Income tax expense (benefit)	(2,773)	—	1,006	26,094	10,779	(48)	35,058
Net income (loss)	\$ 79,373	\$ 76,331	\$ 76,331	\$ 74,882	\$ 21,428	\$ (248,972)	\$ 79,373

SEALY CORPORATION

Supplemental Condensed Consolidating Statements of Operations

Year Ended November 26, 2006

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net sales	\$ —	\$ —	\$ 65,749	\$ 1,177,164	\$ 371,902	\$ (31,972)	\$ 1,582,843
Costs and expenses:							
Cost of goods sold	—	—	38,208	636,605	230,666	(30,552)	874,927
Selling, general and administrative	188	—	6,592	396,700	96,134	—	499,614
Expenses associated with IPO	—	—	—	27,958	552	—	28,510
Amortization of intangibles	5,162	—	—	289	256	—	5,707
Royalty (income) expense, net	(3,782)	—	—	(17,295)	2,222	—	(18,855)
Income from operations	(1,568)	—	20,949	132,907	42,072	(1,420)	192,940
Interest expense	4,148	533	62,668	2,607	2,005	—	71,961
Other (income) expense, net	1,098	—	8,739	(268)	(420)	—	9,149
Loss (income) from equity investees	(78,417)	(78,756)	(78,737)	—	—	235,910	—
Loss (income) from non-guarantor equity investees	—	—	—	(20,872)	—	20,872	—
Capital charge and intercompany interest allocation	—	—	(50,535)	44,272	6,263	—	—
Income (loss) before income taxes and cumulative effect	71,603	78,223	78,814	107,168	34,224	(258,202)	111,830
Income tax expense (benefit)	(2,364)	(194)	58	27,989	12,236	(149)	37,576
Income (loss) before cumulative effect	73,967	78,417	78,756	79,179	21,988	(258,053)	74,254
Cumulative effect of change in accounting principle	—	—	—	221	66	—	287
Net income (loss)	\$ 73,967	\$ 78,417	\$ 78,756	\$ 78,958	\$ 21,922	\$ (258,053)	\$ 73,967

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SEALY CORPORATION

Supplemental Condensed Consolidating Statements of Cash Flows

Year Ended November 30, 2008

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	\$ —	\$ —	\$ 3,069	\$ 22,061	\$ 28,583	\$ —	\$ 53,713
Cash flows from investing activities:							
Purchase of property, plant and equipment	—	—	(152)	(19,569)	(5,254)	—	(24,975)
Proceeds from the sale of property, plant, and equipment	—	—	1	15	46	—	62
Net activity in investment in and advances from (to) subsidiaries and affiliates	6,914	—	594	1,430	(8,938)	—	—
Net cash provided by (used in) investing activities	6,914	—	443	(18,124)	(14,146)	—	(24,913)
Cash flows from financing activities:							
Dividend	(6,811)	—	—	—	—	—	(6,811)
Equity received upon exercise of stock including related excess tax benefits	482	—	—	—	—	—	482
Repurchase of common stock	—	—	—	—	—	—	—
Proceeds from issuance of long term obligations	—	—	—	—	9,305	—	9,305
Repayments of long-term obligations	—	—	(26,212)	(5,526)	(12,717)	—	(44,455)
Borrowings under revolving credit facilities	—	—	243,000	—	40,527	—	283,527
Repayments on revolving credit facilities	—	—	(220,200)	—	(40,417)	—	(260,617)
Other	—	—	(100)	—	—	—	(100)
Net cash used in financing activities	(6,329)	—	(3,512)	(5,526)	(3,302)	—	(18,669)
Effect of exchange rate changes on cash	—	—	—	—	1,858	—	1,858
Change in cash and cash equivalents	585	—	—	(1,589)	12,993	—	11,989
Cash and cash equivalents:							
Beginning of period	4	—	1	4,012	10,590	—	14,607
End of period	\$ 589	\$ —	\$ 1	\$ 2,423	\$ 23,583	\$ —	\$ 26,596

SEALY CORPORATION

Supplemental Condensed Consolidating Statements of Cash Flows

Year Ended December 2, 2007

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	\$ —	\$ —	\$ 5,753	\$ 65,431	\$ 23,198	\$ —	\$ 94,382
Cash flows from investing activities:							
Purchase of property, plant and equipment	—	—	(2,326)	(30,205)	(9,903)	—	(42,434)
Proceeds from the sale of property, plant, and equipment	—	—	1	4,975	89	—	5,065
Net activity in investment in and advances from (to) subsidiaries and affiliates	35,496	—	34,229	(68,781)	(944)	—	—
Net cash provided by (used in) investing activities	35,496	—	31,904	(94,011)	(10,758)	—	(37,369)
Cash flows from financing activities:							
Dividend	(27,389)	—	—	—	—	—	(27,389)
Equity received upon exercise of stock including related excess tax benefits	7,166	—	—	—	—	—	7,166
Repurchase of common stock	(16,253)	—	—	—	—	—	(16,253)
Repayments of long-term obligations	—	—	(79,202)	—	—	—	(79,202)
Borrowings under revolving credit facilities	—	—	211,900	—	22,090	—	233,990
Repayments on revolving credit facilities	—	—	(170,300)	—	(36,343)	—	(206,643)
Other	50	—	(55)	(3,590)	5,708	—	2,113
Net cash used in financing activities	(36,426)	—	(37,657)	(3,590)	(8,545)	—	(86,218)
Effect of exchange rate changes on cash	—	—	—	—	(1,808)	—	(1,808)
Change in cash and cash equivalents	(930)	—	—	(32,170)	2,087	—	(31,013)
Cash and cash equivalents:							
Beginning of period	934	—	1	36,182	8,503	—	45,620
End of period	\$ 4	\$ —	\$ 1	\$ 4,012	\$ 10,590	\$ —	\$ 14,607

SEALY CORPORATION

Supplemental Consolidating Condensed Statements of Cash Flows

Year Ended November 26, 2006

(in thousands)

	Sealy Corporation	Sealy Mattress Corporation	Sealy Mattress Company	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by operating activities	\$ —	\$ —	\$ 6,882	\$ 30,879	\$ 20,464	\$ —	\$ 58,225
Cash flows from investing activities:							
Purchase of property, plant and equipment	—	—	(494)	(23,358)	(7,020)	—	(30,872)
Proceeds from the sale of property, plant, and equipment	—	—	33	388	114	—	535
Net activity in investment in and advances to (from) subsidiaries and affiliates	(69,211)	—	77,199	7,399	(15,387)	—	—
Net cash provided by (used in) investing activities	(69,211)	—	76,738	(15,571)	(22,293)	—	(30,337)
Cash flows from financing activities:							
Proceeds from issuance of common stock	295,348	—	—	—	—	—	295,348
Dividend	(138,648)	—	—	—	—	—	(138,648)
Proceeds from issuance of long-term debt	—	—	440,000	—	—	—	440,000
Repayment of existing long-term debt	(89,114)	—	(522,500)	—	—	—	(611,614)
Equity received upon exercise of stock including related excess tax benefits	2,559	—	—	—	—	—	2,559
Borrowings under revolving credit facilities	—	—	121,900	—	50,281	—	172,181
Repayments under revolving credit facilities	—	—	(121,900)	—	(55,255)	—	(177,155)
Other	—	—	(1,120)	(4,513)	4,024	—	(1,609)
Net cash provided by (used in) financing activities	70,145	—	(83,620)	(4,513)	(950)	—	(18,938)
Effect of exchange rate changes on cash	—	—	—	—	116	—	116
Change in cash and cash equivalents	934	—	—	10,795	(2,663)	—	9,066
Cash and cash equivalents:							
Beginning of period	—	—	1	25,387	11,166	—	36,554
End of period	\$ 934	\$ —	\$ 1	\$ 36,182	\$ 8,503	\$ —	\$ 45,620

Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

Item 9A. *Controls and Procedures*

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal accounting officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of the end of the period covered by this report (the "Evaluation Date"). Based on this evaluation, our principal executive officer and principal accounting officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to the Company, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company's management, including our principal executive officer and principal accounting officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act, identified in connection with the foregoing evaluation that occurred during the fourth quarter of fiscal 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles. Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to change in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, including our principal executive officer and principal accounting officer, conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on its evaluation, our management concluded that our internal control over financial reporting was effective as of the end of the period covered by this report.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Sealy Corporation
Trinity, North Carolina

We have audited the internal control over financial reporting of Sealy Corporation and subsidiaries (the "Company") as of November 30, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 30, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended November 30, 2008 of the Company and our report dated January 13,

2009 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule and includes an explanatory paragraph relating to the adoption of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" and Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" and the number of weeks included in fiscal years 2008, 2007 and 2006.

/s/ DELOITTE & TOUCHE LLP
Charlotte, North Carolina
January 15, 2009

Item 9B. Other Information

On January 12, 2009, the Company announced that Philip Dobbs, resigned as Senior Vice President, Marketing of the Company, which will take effect on January 31, 2009.

PART III

Item 10. Directors and Executive Officers of the Registrant

Executive Officers of the Registrant

Name	Age	Position
Lawrence J. Rogers	60	President and Chief Executive Officer
Jeffrey C. Ackerman	45	Executive Vice President and Chief Financial Officer
G. Michael Hofmann	50	Executive Vice President of Operations, North America
Louis R. Bachicha	52	Executive Vice President of Sales
Philip Dobbs	47	Senior Vice President, Marketing
Kenneth L. Walker	60	Senior Vice President, General Counsel and Secretary

The present principal occupations and recent employment history of each of the executive officers and key employees listed above is as follows:

Lawrence J. Rogers. Mr. Rogers, age 60, was appointed President and Chief Executive Officer effective July 22, 2008. Prior to this appointment, Mr. Rogers served as Interim Chief Executive Officer of the Company since March 12, 2008. From December 15, 2006 through March 12, 2008 Mr. Rogers served as the President, North America. Prior to that, Mr. Rogers was President, Sealy International. Since joining us in 1979, Mr. Rogers has served in numerous other capacities within our operations, including President of Sealy of Canada.

Jeffrey C. Ackerman. Mr. Ackerman, age 45, has been Executive Vice President and Chief Financial Officer since joining us in January 2006. From 1997 until joining us, Mr. Ackerman was a Vice President, Finance with Dade Behring, Inc., a medical diagnostics company. From 1989 to 1997, he served in a variety of finance roles at the Frito-Lay branded snacks division of PepsiCo Inc.

G. Michael Hofmann. Mr. Hofmann, age 50, has been Executive Vice President of Operations, North America since December 15, 2006. Prior to that Mr. Hofmann was Senior Vice President, Operations since October 2002. From 1982 until joining our company, Mr. Hofmann was with Hill-Rom Company, a medical equipment company, serving as its Vice President, Global Engineering from 2001 through 2002, and its Vice President and General Manager, Europe Capital Business Unit from 1995 through 2000. In 2008, Hillenbrand split into two different companies. Hil-Rom is now traded as HRC on the New York Stock Exchange.

Louis R. Bachicha. Mr. Bachicha, age 52, has been Executive Vice President of Sales since February of 2008. Prior to that Mr. Bachicha served as Vice President/Chief Operating Officer of Sealy of Canada. Since joining us in 1984, Mr. Bachicha has served in numerous other capacities with our operations including Vice President Sales—Eastern Region.

Philip Dobbs. Mr. Dobbs, age 47, has been Senior Vice President, Marketing since March 2005. From 2002 until joining our company, Mr. Dobbs was with Cadbury Schweppes, a chewing gum, mint and throat drop manufacturer, serving as its Vice President of Marketing. From 2000 through 2001, he served as Managing Director and President of Heinz Pet Food for HJ Heinz.

Kenneth L. Walker. Mr. Walker, age 60, has been Senior Vice President, General Counsel and Secretary since joining us in May 1997.

Additional information regarding our Board, our Nominating and Corporate Governance Committee, our Audit Committee, our director nomination process, and our Codes of Business Conduct and Ethics for all employees of the Company required by this item is incorporated by reference to all information under the caption entitled "Corporate Governance and Related Matters" included in our Proxy Statement for the 2009 Annual Meeting of Stockholders (the "Proxy Statement").

In addition, Item 1. Business, above contains information relating to the availability of a copy of our Codes of Business Conduct and Ethics on our website.

Information concerning the Board of Directors of the Company, the members of the Company's Audit Committee, the Company's Audit Committee Financial Expert, and compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the sections entitled "Election of Directors and Director Biographies," "Board of Directors Information" and "General—Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement to be filed no later than March 30, 2009.

The information required by this item regarding executive offices of the Company is incorporated herein by reference to "Executive Officers of the Company" in Part I of this report.

Code of Ethics

Our board adopted a code of business conduct and ethics applicable to directors, officers and employees to establish standards and procedures related to the compliance with laws, rules and regulations, treatment of confidential information, conflicts of interest, competition and fair dealing and reporting of violations of the code; and includes a requirement that we make prompt disclosure of any waiver of the code for executive officers or directors made by our board. A copy of the code of business conduct and ethics is available on our website and in print without charge to any person who sends a request to the office of the Secretary of the Company at One Office Parkway, Trinity, North Carolina 27370.

Item 11. Executive Compensation

The information required by this item is incorporated herein by reference to the sections entitled "Executive Compensation," "Leadership Development and Compensation Committee Report," "Board of Directors Information" and "Compensation Committee Interlocks and Insider Participation" in the Company's Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information as of November 30, 2008 regarding the Company's equity compensation plans. The only plan pursuant to which the Company may make equity grants is the Sealy Corporation 2004 Stock Option Plan (the "2004 Stock Option Plan") that was approved by the Board of Directors and the Company's Shareholders on April 6, 2004. The 2004 Stock Option Plan was intended to replace the Sealy Corporation 1998 Stock Option Plan (the "1998 Stock Option Plan"). Since the 2004 Stock Option Plan was approved, no further grants have been made under the 1998 Stock Option Plan.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders(1)	12,286,252	\$ 6.08 per share	3,505,139(2)

(1) These numbers include the 2004 Stock Option Plan and the 1998 Stock Option Plan. The weighted average exercise price in column (b) of the table reflects all such stock options. Restricted shares

and shares of deferred stock or phantom stock units that may be settled in shares of common stock are included in column (a) of the table, but are not included in column (b) for purposes of the weighted average exercise price of stock options. The Company has issued restricted shares under the 2004 Stock Option Plan during fiscal 2008. The issuance of these restricted shares has been considered in column (a) and (c) above. However, the grant of these restricted shares is subject in its entirety to the Company's shareholders' approval of an amendment to the 2004 Stock Option Plan.

(2)

These are shares available for grant as of November 30, 2008 under the 2004 Stock Option Plan pursuant to which the compensation committee of the Board of Directors may make various stock-based awards including grants of cash and cashless exercise stock options, restricted share awards, stock appreciation rights and/or dividend equivalent rights to management and other key employees on terms and subject to conditions as established by the compensation committee of our Board of Directors or certain of the committee's designees. The 2004 Stock Option Plan provided twenty million shares of our Class A common stock for grants. Upon Sealy's March 23, 2006 reverse stock split of 0.7595, the Company has taken the position that only 15,190,000 shares are reserved for grants under the 2004 Stock Option Plan. If stock options granted under the 2004 Stock Option Plan are forfeited or otherwise terminated, then the shares underlying that grant will become available for a subsequent grant under the 2004 Stock Option Plan. To the extent shares underlying forfeited or otherwise terminated options have become available for subsequent grants as of November 30, 2008, they are included in the table as available for grant.

Additional information required by this item is incorporated herein by reference to the sections entitled "Beneficial Ownership of Common Stock" and "Executive Compensation" in the Company's Proxy Statement.

Item 13. *Certain Relationships and Related Transactions and Director Independence*

The information required by this item is incorporated herein by reference to Note 20 of the accompanying Consolidated Financial Statements included in Item 8 of this 10-K and the section entitled "Executive Compensation" and "General—Insider Transactions" in the Company's Proxy Statement.

Item 14. *Principal Accountant Fees and Services*

The information required by this item is incorporated herein by reference to the section entitled "Audit Committee Report and Fees Paid to Independent Registered Public Accounting Firm" in the Company's Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

Documents filed as a part of the report:

- (1) Financial Statements.
Consolidated Balance Sheets at November 30, 2008 and December 2, 2007.
Consolidated Statements of Operations for the years ended November 30, 2008, December 2, 2007, and November 26, 2006.
Consolidated Statements of Stockholders' Deficit for the years ended November 30, 2008, December 2, 2007, and November 26, 2006.
Consolidated Statements of Cash Flows for the years ended November 30, 2008, December 2, 2007, and November 26, 2006.
Notes to Consolidated Financial Statements
- (2) Financial Statement Schedules.
Schedule I—Consolidated Valuation and Qualifying Accounts
- (3) Exhibits.
The exhibits listed in the accompanying Exhibit Index are filed as a part of this report.

The following exhibits are filed as part of this Registration Statement:

Exhibit Number	Description of Exhibit
2.1	Agreement and Plan of Merger, dated as of March 3, 2004, by and between Sealy Corporation and Posturepedic Acquisition Corp. (incorporated herein by reference to Exhibit 2.1 to Sealy Corporation's Current Report on Form 8-K (File No. 1-8738) filed April 15, 2004) (Sealy Corporation agrees to furnish a copy of any omitted schedules or similar supplements to the SEC upon request)
2.2	First Amendment to the Agreement and Plan of Merger, dated April 5, 2004, by and between Sealy Corporation and Sealy Acquisition Corp. (incorporated herein by reference to Exhibit 2.2 to Sealy Corporation's Current Report on Form 8-K (File No. 1-8738) filed April 15, 2004) (Sealy Corporation agrees to furnish a copy of any omitted schedules or similar supplements to the SEC upon request)
3.1	Amended and Restated Certificate of Incorporation of Sealy Corporation dated as of March 23, 2006 (incorporated herein by reference to Exhibit 3.1 to Sealy Corporation's Registration Statement on Form S-1/A (File No. 1-8738) filed March 24, 2006)
3.2	Amended and Restated Bylaws of Sealy Corporation dated as of December 20, 2007 (incorporated herein by reference to Sealy Corporation's report on Form 8-K (File No. 1-8738) filed December 21, 2007)
4.1	Indenture, dated as of April 6, 2004, by and among Sealy Mattress Company, the Guarantors named therein and The Bank of New York Trust Company, N.A., as trustee, with respect to the 8.25% Senior Subordinated Notes due 2014 and the 8.25% Senior Subordinated Exchange Notes due 2014 (incorporated herein by reference to Exhibit 4.1 to Sealy Mattress Company's Registration Statement on Form S-4 (File No. 333-117081) filed July 1, 2004)
4.2	First Supplemental Indenture, dated as of June 28, 2004, among Sealy Mattress Company, Sealy Corporation, Sealy Mattress Corporation and the subsidiary guarantors named therein and The Bank of New York Trust Company, N.A., as trustee, with respect to the 8.25% Senior Subordinated Notes due 2014 and the 8.25% Senior Subordinated Exchange Notes due 2014 (incorporated herein by reference to Exhibit 4.3 to Sealy Mattress Company's Registration Statement on Form S-4 (File No. 333-117081) filed July 1, 2004)
4.3	Note and Stock Purchase Agreement, dated as of July 16, 2004, between Sealy Corporation and the Purchasers named therein, with respect to the 10% Senior Subordinated Notes due 2015 and Common Stock, par value \$0.01 per share (incorporated by reference to Exhibit 4.4 to Sealy Corporation's Registration Statement S-1 (File No. 1-8738) filed June 30, 2005)
4.4	Second Supplemental Indenture, dated as of May 25, 2006, among Sealy Corporation, Sealy Mattress Company, Sealy Mattress Corporation, the Guarantors listed on Schedule I thereto and The Bank of New York Trust Company, as trustee (incorporated herein by reference to Sealy Corporation Current Report on Form 8-K (File No. 1-8738) filed May 31, 2006)
*10.1	Sealy Profit Sharing Plan, Amended and Restated, dated December 1, 1989 (incorporated herein by reference to Exhibit 10.1 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended November 30, 1995 (File No. 1-8738) filed February 27, 1996)
*10.2	Amendment No. 1 to Sealy Profit Sharing Plan (incorporated herein by reference to Exhibit 10.21 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 1, 1996 (File No. 1-8738) filed March 3, 1997)

**Exhibit
Number****Description of Exhibit**

*10.3	Amendment No. 2 to Sealy Profit Sharing Plan (incorporated herein by reference to Exhibit 10.22 to Sealy Mattress Corporation's Annual Report on Form 10-K for the fiscal year ended December 1, 1996 (File No. 1-8738) filed March 3, 1997)
*10.4	Sealy Corporation Bonus Program (incorporated herein by reference to Exhibit 10.5 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended November 30, 1995 (File No. 1-8738) filed February 27, 1996)
*10.5	Amendment No. 1 to Sealy Bonus Plan (incorporated herein by reference to Exhibit 10.17 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 1, 1996 (File No. 1-8738) filed March 3, 1997)
*10.6	Sealy Corporation 1998 Stock Option Plan (incorporated herein by reference to Exhibit 10.48 to Sealy Corporation's Quarterly Report on Form 10-Q for the quarterly period ended March 1, 1998 (File No. 1-8738) filed April 15, 1998)
*10.7	2004 Stock Option Plan for Key Employees of Sealy Corporation and its Subsidiaries (incorporated herein by reference to Exhibit 4.4 to Sealy Corporation's Registration Statement on Form S-8 (File No. 333-113987) filed March 26, 2004)
*10.8	Form of Management Stockholder's Agreement (incorporated herein by reference to Exhibit 4.5 to Sealy Corporation's Registration Statement on Form S-8 (File No. 333-113987) filed March 26, 2004)
*10.9	Form of Sale Participation Agreement (incorporated herein by reference to Exhibit 4.6 to Sealy Corporation's Registration Statement on Form S-8 (File No. 333-113987) filed March 26, 2004)
*10.10	Form of Stock Option Agreement (incorporated herein by reference to Exhibit 4.7 to Sealy Corporation's Registration Statement on Form S-8 (File No. 333-113987) filed March 26, 2004)
*10.11	Form of Rollover Agreement (incorporated herein by reference to Exhibit 4.9 to Sealy Corporation's Registration Statement on Form S-8 (File No. 333-113987) filed March 26, 2004)
10.12	Stockholders' Agreement, dated as of July 16, 2004, among Sealy Corporation, The Northwestern Mutual Life Insurance Company, Teachers Insurance and Annuity Association of America and Sealy Paterson LLC and Sealy Holding LLC (incorporated herein by reference to Exhibit 10.12 to Sealy Corporation's Registration Statement on Form S-1/A (File No. 1-8738) filed March 24, 2006)
10.13	Stockholders' Agreement, dated as of April 6, 2004, among Sealy Corporation, Bain Capital Fund V, L.P., Bain Capital Fund V, L.P., BCIP Associates, BCIP Trust Associates, L.P., Harvard Private Capital Holdings, Inc., Sealy Investors 1, LLC, Sealy Investors 2, LLC, Sealy Investors 3, LLC and Sealy Holding LLC (incorporated herein by reference to Exhibit 10.13 to Sealy Mattress Company's Registration Statement on Form S-4 (File No. 333-117081) filed July 1, 2004)
10.14	Registration Rights Agreement, dated as of April 6, 2004, among Sealy Corporation and Sealy Holding LLC (incorporated herein by reference to Exhibit 10.14 to Sealy Mattress Company's Registration Statement on Form S-4 (File No. 333-117081) filed July 1, 2004)

**Exhibit
Number****Description of Exhibit**

10.15	Second Amended and Restated Credit Agreement dated April 14, 2005 among Sealy Mattress Company, Sealy Canada, LTD./LTEE, the Guarantors named therein, Sealy Mattress Corporation, Sealy Corporation, JPMorgan Chase Bank, as administrative agent, J.P. Morgan Securities Inc., as joint lead arranger, Goldman Sachs Credit Partners, L.P., as joint lead arranger, General Electric Capital Corporation, as co-documentation agent, Royal Bank of Canada as co-documentation agent, and other lenders from time to time parties thereto (incorporated herein by reference to Exhibit 10.21 to Sealy Mattress Corporation's Current Report on Form 8-K (File No. 333-117081) filed April 20, 2005)
*10.16	Employment Agreement, dated as of August 25, 1997, by and between Sealy Corporation and Jeffrey C. Claypool (incorporated herein by reference to Exhibit 10.8 to Sealy Corporation's Current Report on Form 8-K (File No. 1-8738) filed January 2, 1998)
*10.17	Employment Agreement, dated as of August 25, 1997, by and between Sealy Corporation and Lawrence J. Rogers (incorporated herein by reference to Exhibit 10.12 to Sealy Corporation's Current Report on Form 8-K (File No. 1-8738) filed January 2, 1998)
*10.18	Amendment to Employment Agreement, dated as of December 17, 1997, between the employees named therein and Sealy Corporation (incorporated herein by reference to Exhibit 10.19 to Sealy Corporation's Current Report on Form 8-K (File No. 1-8738) filed January 2, 1998)
*10.19	Amendment to Employment Agreement dated January 20, 2000 by and between Sealy Corporation and Lawrence J. Rogers (incorporated herein by reference to Exhibit 10.33 to Sealy Mattress Company's Registration Statement on Form S-4 (File No. 333-67478) filed December 21, 2001)
*10.20	Employment Agreement, dated as of May 25, 2001 by and between Sealy Corporation and Charles Dawson (incorporated herein by reference to Exhibit 10.37 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 1, 2002 (File No. 1-8738) filed March 3, 2003)
*10.21	Employment Agreement, dated as of September 17, 2002 by and between Sealy Corporation and Kenneth L. Walker (incorporated herein by reference to Exhibit 10.36 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 1, 2002 (File No. 1-8738) filed March 3, 2003)
*10.22	Employment Agreement, dated as of October 1, 2002 by and between Sealy Corporation and G. Michael Hofmann (incorporated herein by reference to Exhibit 10.38 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 1, 2002 (File No. 1-8738) filed March 3, 2003)
*10.23	Amended Employment Agreement, dated as of January 14, 2005 by and between Sealy Corporation and David J. McIlquham (incorporated herein by reference to Exhibit 10.21 to Sealy Mattress Corporation's Annual Report on Form 10-K for the fiscal year ended November 28, 2004 (File No. 333-117081) filed February 28, 2005)
*10.24	Employment Agreement, dated April 1, 2005, by and between Sealy Corporation and Philip Dobbs (incorporated herein by reference to Exhibit 10.27 to Sealy Corporation's Registration Statement on Form S-1/A (File No. 1-8738) filed March 24, 2006)
*10.25	Sealy Corporation Executive Severance Benefit Plan dated January 25, 1993 (incorporated herein by reference to the appropriate Exhibit to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended November 30, 1992 (File No. 1-8738))

**Exhibit
Number****Description of Exhibit**

*10.26	Sealy Corporation Directors' Deferred Compensation Plan dated December 13, 2004 (incorporated herein by reference to Exhibit 10.29 to Sealy Mattress Corporation's Annual Report on Form 10-K for the fiscal year ended November 28, 2004 (File No. 333-117081) filed February 28, 2005)
*10.27	Form of Stock Option Agreement (Special Retirement Only), dated as of July 20, 2004 by and between Sealy Corporation and Jeffrey C. Claypool (incorporated herein by reference to Exhibit 10.31 to Sealy Mattress Corporation's Annual Report on Form 10-K for the fiscal year ended November 28, 2004 (File No. 333-117081) filed February 28, 2005)
*10.28	Form of Stock Option Agreement (Special Retirement Only), dated as of July 20, 2004 by and between Sealy Corporation and Lawrence J. Rogers (incorporated herein by reference to Exhibit 10.32 to Sealy Mattress Corporation's Annual Report on Form 10-K for the fiscal year ended November 28, 2004 (File No. 333-117081) filed February 28, 2005)
*10.29	Employment Agreement dated September 12, 2006 by and between Sealy Corporation and Jeffrey C. Ackerman (incorporated by reference to exhibit 10.3 to Sealy Corporation's Quarterly Report on Form 10-Q for the fiscal quarter ended August 27, 2006 (File No. 1-8737) filed October 11, 2006)
10.30	Third Amended and Restated Credit Agreement, dated August 25, 2006 (incorporated herein by reference to Sealy Corporation Report on Form 8-K (File No. 1-8738) filed on August 30, 2006).
10.31	Management Services Agreement with Kohlberg Kravis Roberts & Co. L.P. dated April 6, 2004 (incorporated herein by reference to Exhibit 10.33 to Sealy Corporation's Registration Statement on Form S-1 (File No. 333-126280) filed August 12, 2005)
10.32	Form of Management Services Termination Agreement (incorporated herein by reference to Exhibit 10.34 to Sealy Corporation's Registration Statement on Form S-1 (File No. 333-126280) filed September 12, 2005)
10.33	Supply Agreement, dated February 18, 2003, between Sealy, Inc. and Nomaco Inc. (incorporated herein by reference to Exhibit 10.35 to Sealy Corporation's Registration Statements on Form S-1 (File No. 333-126280) filed September 12, 2005) (portions of this exhibit have been omitted pursuant to a request for confidential treatment)
10.34	Joinder, dated as of September 8, 2004, to the Stockholders' Agreement dated April 6, 2004 (incorporated herein by reference to Exhibit 10.36 to Sealy Corporation's Registration Statement on Form S-1 (File No. 333-126280) filed September 12, 2005)
*10.35	Amendment No. 1 to the 2004 Stock Option Plan for Key Employees of Sealy Corporation and its Subsidiaries adopted July 25, 2007 (incorporated herein by reference to Exhibit 10.1 to Sealy Corporation's Quarterly Report on Form 10-Q for the fiscal quarter ended August 26, 2007 (File No. 1-8738) filed October 4, 2007)
*10.36	Amendment No. 1 to the Sealy Corporation 1998 Stock Option Plan adopted October 26, 2007 (incorporated herein by reference to Exhibit 10.38 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 2, 2007 (File No. 1-8738) filed January 31, 2008)
*10.37	Amendment No. 2 to the 2004 Stock Option Plan for Key Employees of Sealy Corporation and its subsidiaries adopted October 26, 2007 (incorporated herein by reference to Exhibit 10.39 to Sealy Corporation's Annual Report on Form 10-K for the fiscal year ended December 2, 2007 (File No. 1-8738) filed January 31, 2008).

**Exhibit
Number****Description of Exhibit**

*10.38	Employment Agreement dated April 17, 2008 by and between Sealy Corporation and Louis R. Bachicha (incorporated herein by reference to Exhibit 10.40 to Sealy Corporation's Quarterly Report on Form 10-Q for the fiscal quarter ended June 2, 2008 (File No. 1-8738) filed July 8, 2008)
*10.39	Amended Employment Agreement dated July 22, 2008 by and between Sealy Corporation and Lawrence J. Rogers (incorporated herein by reference to Exhibit 10.1 to Sealy Corporation's Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 2008 (File No. 1-8738) filed October 7, 2008)
*10.40	Restricted Stock Award Agreement dated July 22, 2008 by and between Sealy Corporation and Lawrence J. Rogers (incorporated herein by reference to Exhibit 10.2 to Sealy Corporation's Quarterly Report on Form 10-Q for the fiscal quarter ended August 31, 2008 (File No. 1-8738) filed October 7, 2008)
*†10.41	Amended and Restated Equity Plan for Key Employees of Sealy Corporation and its Subsidiaries, adopted November 6, 2008 and effective December 16, 2008.
*†10.42	Amended and Restated Sealy Corporation Directors' Deferred Compensation Plan adopted December 17, 2008.
*†10.43	Amended and Restated Sealy Corporation Bonus Plan dated December 18, 2008.
*†10.44	Amendment and Restatement of the Sealy Benefit Equalization Plan dated December 18, 2008.
*†10.45	Amendment and Restatement of the Sealy Executive Severance Benefit Plan dated December 18, 2008.
*†10.46	Amendment to Employment Agreement, dated December 30, 2008, between Sealy Corporation and Lawrence J. Rogers, Jeffrey C. Ackerman, Louis R. Bachicha, Philip Dobbs, G. Michael Hoffman, Alan Letton, Steven Rusing, David Twine and Kenneth L. Walker.
†12.1	Computation of Ratio of Earnings to Fixed Charges
†21.1	Subsidiaries of Sealy Corporation
†23.1	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm, with respect to the incorporation by reference of its audit reports into Sealy Corporation's Registration Statement on Form S-8 (file No. 333-139794)
†31.1	Chief Executive Officer Certification of the Type Described in Rule 13a-14(a) and Rule 15d-14(a)
†31.2	Chief Financial Officer Certification of the Type Described in Rule 13a-14(a) and Rule 15d-14(a)
†32.1	Certification Pursuant to 18 U.S.C. Section 1350.

* Management contract or compensatory plan or arrangement required to be filed (and/or incorporated by reference) as an exhibit to this Annual Report on Form 10-K.

† Filed herewith.

Schedule I—Consolidated Valuation and Qualifying Accounts

	Fiscal Year		
	2008	2007	2006
Allowance for doubtful accounts			
Balance beginning of period	\$ 9,705	\$ 8,543	\$ 10,569
Charged to costs and expenses	10,279	6,620	2,705
Charged to other accounts	—	—	—
Deductions	6,631(1)	5,458(1)	4,731(1)
Balance at end of period	\$ 13,353	\$ 9,705	\$ 8,543
Reserve for discounts and returns			
Balance beginning of period	\$ 16,715	\$ 14,037	\$ 9,840
Charged to costs and expenses	18,454	29,246	27,903
Charged to other accounts	—	—	—
Deductions	23,612(2)	26,568(2)	23,706(2)
Balance at end of period	\$ 11,557	\$ 16,715	\$ 14,037
Reserve for inventory obsolescence			
Balance beginning of period	\$ 2,648	\$ 1,831	\$ 1,828
Charged to costs and expenses	2,059	1,809	1,500
Charged to other accounts	—	—	—
Deductions	2,880(3)	992(3)	1,497(3)
Balance at end of period	\$ 1,827	\$ 2,648	\$ 1,831
Deferred tax asset valuation			
Balance beginning of period	\$ 25,227	\$ 28,762	\$ 30,259
Charged to costs and expenses	6,365	2,702	1,242
Charged to other accounts	(2,979)	(1,712)	(139)
Deductions	(668)	4,525	2,600
Balance at end of period	\$ 27,945	\$ 25,227	\$ 28,762

- (1) Uncollectible accounts written off, net of recoveries.
- (2) Cash discounts taken and accommodation returns.
- (3) Net deductions recorded to the inventory reserve to appropriately adjust balance.

SIGNATURES

Pursuant to the requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, Sealy Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SEALY CORPORATION

By:

/s/ LAWRENCE J. ROGERS

Lawrence J. Rogers
President and Chief Executive Officer
(Principal Executive Officer)

Date: January 15, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ LAWRENCE J. ROGERS</u> Lawrence J. Rogers	President and Chief Executive Officer (Principal Executive Officer)	January 15, 2009
<u>/s/ JEFFREY C. ACKERMAN</u> Jeffrey C. Ackerman	Executive Vice President and Chief Financial Officer (Principal Accounting Officer)	January 15, 2009
<u>/s/ BRIAN F. CARROLL</u> Brian F. Carroll	Director	January 15, 2009
<u>/s/ JAMES W. JOHNSTON</u> James W. Johnston	Director	January 15, 2009
<u>/s/ GARY E. MORIN</u> Gary E. Morin	Director	January 15, 2009
<u>/s/ DEAN B. NELSON</u> Dean B. Nelson	Director	January 15, 2009
<u>/s/ PAUL NORRIS</u> Paul Norris	Director	January 15, 2009

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ RICHARD W. ROEDEL</u> Richard W. Roedel	Director	January 15, 2009
<u>/s/ SCOTT M. STUART</u> Scott M. Stuart	Director	January 15, 2009

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AMENDED AND RESTATED EQUITY PLAN
FOR KEY EMPLOYEES OF
SEALY CORPORATION AND ITS SUBSIDIARIES

1. Purpose of Plan

This Amended and Restated Equity Plan for Key Employees of Sealy Corporation and Its Subsidiaries (the "Plan") is designed:

- (a) to amend and restate, in its entirety, the 2004 Stock Option Plan for Key Employees of Sealy Corporation and Its Subsidiaries, dated as of April 6, 2004.
- (b) to promote the long term financial interests and growth of Sealy Corporation (the "Company") and its Subsidiaries by attracting and retaining management and other personnel with the training, experience and ability to enable them to make a substantial contribution to the success of the Company's business;
- (c) to motivate management personnel by means of growth-related incentives to achieve long range goals; and
- (d) to further the alignment of interests of participants with those of the stockholders of the Company through opportunities for increased stock, or stock-based ownership in the Company.

2. Definitions

The following capitalized terms used in the Plan have the respective meaning set forth in this Section:

- (a) "Affiliate" of any Person means with respect to any Person, any entity directly or indirectly, through one or more intermediaries, controlling, controlled by or under common control with such first Person.
 - (b) "Award" means Stock Option, Stock Appreciation Right, Dividend Equivalent Rights or Other Stock-Based Award pursuant to the Plan.
 - (c) "Board" means the board of directors of the Company.
 - (d) "Change in Control" means (i) the sale or disposition, in one or a series of related transactions, of all or substantially all of the assets of the Company to an Unaffiliated Person; (ii) a sale resulting in more than 50% of the voting stock of the Company being held by an Unaffiliated Person; or (iii) a merger, consolidation, recapitalization or reorganization of the Company with or into another Unaffiliated Person; *if and only if* any such event listed in clauses (i) through (iii) above results in the inability of KKR, the Investor or any member or members of the Investor, to designate or elect a majority of the Board (or the board of directors of the resulting entity or its parent company). For purposes of this definition, the term "Unaffiliated Person" means any Person or Group who is not (x) KKR, the Investor or any member of the
-

Investor, (y) an Affiliate of KKR, the Investor or any member of the Investor, or (z) an entity in which KKR, the Investor, or any member of the Investor holds, directly or indirectly, a majority of the economic interests in such entity.

(e) “Code” means the Internal Revenue Code of 1986, as amended, or any successor thereto.

(f) “Committee” means the Human Resources Committee of the Board (or any sub-committee thereof meeting the requirements of Section 162(m) of the Code, to the extent the Company desires to make grants to “covered employees” as defined in Section 162(m) of the Code).

(g) “Common Stock” or “Share” means the Class A common stock, par value \$0.01 per share, of the Company, which may be authorized but unissued, or issued and reacquired.

(h) “Employee” means a person, including an officer, in the regular employment of the Company or one of its Subsidiaries who, in the opinion of the Committee, is, or is expected to have involvement in the management, growth or protection of some part or all of the business of the Company.

(i) “Employment” refers to (i) a Participant’s employment if the Participant is an employee of the Company or any of its Affiliates, (ii) a Participant’s services as a consultant, if the Participant is consultant to the Company or its Affiliates and (iii) a Participant’s services as a non-employee director, if the Participant is a non-employee member of the Board.

(j) “Exchange Act” means the Securities Exchange Act of 1934, as amended, or any successor thereto.

(k) “Fair Market Value” means the price per share of Common Stock (i) if there is a public market for the Shares on such date, the closing trading price of the Shares on such stock exchange on which the Shares are principally trading on the applicable date, or, if there were no sales on such date, on the closest preceding date on which there were sales of Shares or (ii) if there is no public market for the Shares on such date, the fair market value of the Shares as determined in the good faith discretion of the Board.

(l) “Grant” means an award made to a Participant pursuant to the Plan and described in Section 5, including, without limitation, an award of a Stock Option, Stock Appreciation Right or Dividend Equivalent Right (as such terms are defined in Section 5), or any combination of the foregoing.

(m) “Grant Agreement” means an agreement between the Company and a Participant that sets forth the terms, conditions and limitations applicable to a Grant.

(n) “Group” means “group,” as such term is used for purposes of Section 13(d) or 14(d) of the Exchange Act.

(o) “Investor” means Sealy Holding LLC.

(p) “KKR” shall mean the KKR Millennium Fund L.P.

(q) “Participant” means an Employee, non-employee member of the Board, consultant or other person having a relationship with the Company or one of its Subsidiaries, to whom one or more Grants have been made and remain outstanding.

(r) “Person” means “person,” as such term is used for purposes of Section 13(d) or 14(d) of the Exchange Act.

(s) “Subsidiary” means a subsidiary corporation, as defined in Section 424(f) of the Code (or any successor section thereto).

3. Administration of Plan

(a) The Plan shall be administered by the Committee. The Committee may adopt its own rules of procedure, and action of a majority of the members of the Committee taken at a meeting, or action taken without a meeting by unanimous written consent, shall constitute action by the Committee. The Committee shall have the power and authority to administer, construe and interpret the Plan, to make rules for carrying it out and to make changes in such rules. Any such interpretations, rules, and administration shall be consistent with the basic purposes of the Plan.

(b) The Committee may delegate to the Chief Executive Officer and to other senior officers of the Company its duties under the Plan subject to the limits of applicable law and such other conditions and limitations as the Committee shall prescribe, except that only the Committee may designate and make Grants to Participants who are subject to Section 16 of the Exchange Act.

(c) The Committee may employ counsel, consultants, accountants, appraisers, brokers or other persons. The Committee, the Company, and the officers and directors of the Company shall be entitled to rely upon the advice, opinions or valuations of any such persons. All actions taken and all interpretations and determinations made by the Committee in good faith shall be final and binding upon all Participants, the Company and all other interested persons. No member of the Committee shall be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or the Grants, and all members of the Committee shall be fully protected by the Company with respect to any such action, determination or interpretation.

4. Eligibility

The Committee may from time to time make Grants under the Plan to such Employees, or other persons having a relationship with Company or any of its Subsidiaries, and in such form and having such terms, conditions and limitations as the Committee may determine. The terms, conditions and limitations of each Grant under the Plan shall be set forth in a Grant Agreement, in a form approved by the Committee, consistent, however, with the terms of the Plan; provided, however, that such Grant Agreement shall contain provisions dealing with the treatment of Grants in the event of the termination of employment, death or disability of a Participant, and

may also include provisions concerning the treatment of Grants in the event of a Change in Control of the Company.

5. Grants

From time to time, the Committee will determine the forms and amounts of Grants for Participants. Such Grants may take the following forms in the Committee's sole discretion:

- (a) Stock Options. These are options to purchase Common Stock. At the time of Grant the Committee shall determine, and shall include in the Grant Agreement or other Plan rules, the option exercise period, the option exercise price, vesting requirements, and such other terms, conditions or restrictions on the grant or exercise of the option as the Committee deems appropriate including, without limitation, the right to receive dividend equivalent payments on vested and/or unvested options, except that in no event shall the option exercise price be less than the Fair Market Value on the date of grant of the Stock Option. In addition to other restrictions contained in the Plan, an option granted under this Section 5(a) may not be exercised more than 10 years after the date it is granted. Payment of the option exercise price shall be made in cash or in shares of Common Stock, or a combination thereof, in accordance with the terms of the Plan, the Grant Agreement and any applicable guidelines of the Committee in effect at the time.
- (b) Stock Appreciation Rights. The Committee may grant Stock Appreciation Rights in tandem with the grant of a Stock Option or standing alone. Each Stock Appreciation Right shall be subject to such terms as the Committee may determine. A Stock Appreciation Right means the right to transfer and surrender to the Company all or a portion of a Stock Option (if granted in tandem with a Stock Option) in exchange for an amount, or otherwise means the right to receive an amount, equal to the excess of (i) the aggregate Fair Market Value, as of the date such right is exercised, of the Common Stock underlying by such Option or portion thereof, over (ii) the aggregate exercise price of such right, relating to such Common Stock. Such amount may be paid in cash or be satisfied with shares, at the Committee's discretion. In no event shall the Stock Appreciation Right exercise price be less than the Fair Market Value on the date of grant of the Stock Appreciation Right.
- (c) Dividend Equivalent Rights. The Committee may grant Dividend Equivalent Rights either alone or in connection with the grant of an Award. A Dividend Equivalent Right means the right to receive a payment in respect of one share of Common Stock (whether or not subject to an Award) equal to the amount of any dividend paid in respect of one share of Common Stock held by a shareholder in the Company. Each Dividend Equivalent Right shall be subject to such terms as the Committee may determine.
- (d) Other Stock-Based Awards. The Committee, in its sole discretion, may grant or sell Awards of Shares, Awards of restricted shares of Common Stock and Awards that are valued in whole or in part by reference to, or are otherwise based on the Fair Market Value of, shares of Common Stock (the "Other Stock-Based Awards"). Such Other Stock-Based Awards shall be in such form, and dependent on such conditions, as the Committee shall determine, including, without limitation, the right to receive, or vest with respect to, one or more shares of Common Stock (or the equivalent cash value of such shares) upon the completion of a specified period of

service, the occurrence of an event and/or the attainment of performance objectives. Other Stock-Based Awards may be granted alone or in addition to any other Stock Awards granted under the Plan. Subject to the provisions of the Plan, the Committee shall determine to whom and when Other Stock-Based Awards will be made, the number of shares of Common Stock to be awarded under (or otherwise related to) such Other Stock-Based Awards; whether such Other Stock-Based Awards shall be settled in cash, shares or a combination of cash and shares; and all other terms and conditions of such Awards (including, without limitation, the vesting provisions thereof and provisions ensuring that all shares so awarded and issued shall be fully paid and non-assessable).

Notwithstanding anything to the contrary herein, certain Other Stock-Based Awards granted under this Section 6 may be granted in a manner which is intended to be deductible by the Company under Section 162(m) of the Code (or any successor section thereto) (“Performance-Based Awards”). A Participant’s Performance-Based Award shall be determined based on the attainment of written performance goals approved by the Committee for a performance period established by the Committee (i) while the outcome for that performance period is substantially uncertain and (ii) no more than 90 days after the commencement of the performance period to which the performance goal relates or, if less, the number of days which is equal to 25 percent of the relevant performance period. The performance goals, which must be objective, shall be based upon one or more of the following criteria: (i) consolidated earnings before or after taxes (including earnings before interest, taxes, depreciation and amortization); (ii) net income; (iii) operating income; (iv) earnings per Share; (v) book value per Share; (vi) return on shareholders’ equity; (vii) expense management; (viii) return on investment; (ix) improvements in capital structure; (x) profitability of an identifiable business unit or product; (xi) maintenance or improvement of profit margins; (xii) stock price; (xiii) market share; (xiv) revenues or sales; (xv) costs; (xvi) cash flow; (xvii) working capital (xviii) return on assets and (xix) total shareholder return. The foregoing criteria may relate to the Company, one or more of its Affiliates or one or more of its or their divisions or units, or any combination of the foregoing, and may be applied on an absolute basis and/or be relative to one or more peer group companies or indices, or any combination thereof, all as the Committee shall determine. In addition, to the degree consistent with Section 162(m) of the Code (or any successor section thereto), the performance goals may be calculated without regard to extraordinary items. The maximum amount of a Performance-Based Award during a calendar year to any Participant shall be: (x) with respect to Performance-Based Awards that are denominated in Shares, 5,000,000 Shares and (y) with respect to Performance-Based Awards that are not denominated in Shares, \$10,000,000. The Committee shall determine whether, with respect to a performance period, the applicable performance goals have been met with respect to a given Participant and, if they have, shall so certify and ascertain the amount of the applicable Performance-Based Award. No Performance-Based Awards will be paid for such performance period until such certification is made by the Committee. The amount of the Performance-Based Award actually paid to a given Participant may be less than the amount determined by the applicable performance goal formula, at the discretion of the Committee. The amount of the Performance-Based Award determined by the Committee for a performance period shall be paid to the Participant at such time as determined by the Committee in its sole discretion after the end of such performance period; provided, however, that a Participant may, if and to the extent permitted by the Committee and consistent with the provisions of Section 162(m) of the Code, elect to defer payment of a Performance-Based Award.

6. Limitations and Conditions

- (a) The number of Shares available for Grants under this Plan shall be 15,190,000 unless restricted by applicable law, Shares related to Grants that are forfeited, terminated, canceled or expire unexercised, shall immediately become available for new Grants.
- (b) No Grants shall be made under the Plan beyond ten years after the effective date of the Plan, but the terms of Grants made on or before the expiration of the Plan may extend beyond such expiration. At the time a Grant is made or amended or the terms or conditions of a Grant are changed in accordance with the terms of the Plan or the Grant Agreement, the Committee may provide for limitations or conditions on such Grant.
- (c) Nothing contained herein shall affect the right of the Company or any of its Subsidiaries to terminate any Participant's employment at any time or for any reason.
- (d) Other than as specifically provided in the Form of Management Stockholder's Agreement attached hereto as Exhibit A, no benefit under the Plan shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, or charge, and any attempt to do so shall be void. No such benefit shall, prior to receipt thereof by the Participant, be in any manner liable for or subject to the debts, contracts, liabilities, engagements, or torts of the Participant.
- (e) Participants shall not be, and shall not have any of the rights or privileges of, stockholders of the Company in respect of any Shares purchasable in connection with any Grant unless and until certificates representing any such Shares have been issued by the Company to such Participants (or book entry representing such shares has been made and such Shares have been deposited with the appropriate registered book-entry custodian).
- (f) No election as to benefits or exercise of any Grant may be made during a Participant's lifetime by anyone other than the Participant except by a legal representative appointed for or by the Participant.
- (g) Absent express provisions to the contrary, any Grant under this Plan shall not be deemed compensation for purposes of computing benefits or contributions under any retirement plan of the Company or its Subsidiaries and shall not affect any benefits under any other benefit plan of any kind now or subsequently in effect under which the availability or amount of benefits is related to level of compensation. This Plan is not a "Retirement Plan" or "Welfare Plan" under the Employee Retirement Income Security Act of 1974, as amended.
- (h) Unless the Committee determines otherwise, no benefit or promise under the Plan shall be secured by any specific assets of the Company or any of its Subsidiaries, nor shall any assets of the Company or any of its Subsidiaries be designated as attributable or allocated to the satisfaction of the Company's obligations under the Plan.

7. Transfers and Leaves of Absence

For purposes of the Plan, unless the Committee determines otherwise: (a) a transfer of a Participant's employment without an intervening period of separation among the Company and any Subsidiary (or among any Subsidiaries) shall not be deemed a termination of employment, and (b) a Participant who is granted in writing a leave of absence or who is entitled to a statutory leave of absence shall be deemed to have remained in the employ of the Company (and any Subsidiary) during such leave of absence.

8. Adjustments

In the event of any change in the outstanding Shares by reason of any Share dividend or split, or in the event of any reorganization, recapitalization, merger, consolidation, spin-off, combination, combination or transaction or exchange of Shares or other corporate exchange, or any distribution to shareholders of Shares other than regular cash dividends, or any transaction similar to the foregoing, the Committee in its sole discretion and without liability to any person shall make such substitution or adjustment, if any, as it deems to be equitable (subject to Section 14(c) below), as to (i) the number or kind of Shares or other securities issued or reserved for issuance pursuant to the Plan or pursuant to outstanding Awards, (ii) the maximum number of Shares for which Options or Stock Appreciation Rights may be granted during a calendar year to any Participant (iii) the maximum amount of a Performance-Based Award that may be granted during a calendar year to any Participant, (iv) the Option Price or exercise price of any Stock Appreciation Right and/or (v) any other affected terms of such Awards.

9. Merger, Consolidation, Exchange, Acquisition, Liquidation or Dissolution

(a) In its absolute discretion, acting in good faith, and on such terms and conditions as it deems appropriate, coincident with or after the grant of any Grant, the Committee may provide that such Grant cannot be exercised after the amalgamation, merger or consolidation of the Company with or into another corporation, the exchange of all or substantially all of the assets of the Company for the securities of another corporation, the acquisition by another corporation of 80% or more of the Company's then outstanding shares of voting stock or the recapitalization, reorganization, reclassification, liquidation, dissolution, or other event affecting the capital stock of the Company, and the Committee shall, on such terms and conditions as it deems appropriate, acting in good faith, also provide, either by the terms of such Grant or by a resolution adopted prior to the occurrence of such amalgamation, merger, consolidation, exchange, acquisition, recapitalization, reorganization, reclassification, liquidation, dissolution or other event affecting the capital stock of the Company, that, after written notice to all affected Participants and for a reasonable period of time prior to such event, such Grant shall be exercisable as to any Shares subject thereto which is being made unexercisable after any such event, notwithstanding anything to the contrary herein (but subject to the provisions of Section 7(b)) and that, upon the occurrence of such event, such Grant shall terminate and be of no further force or effect; provided, however, that the Committee may also provide, in its absolute discretion, that even if the Grant shall remain exercisable after any such event, from and after such event, any such Grant shall be exercisable only for the kind and amount of securities and/or other property, or the cash equivalent thereof (as determined by the Committee in good faith),

receivable as a result of such event by the holder of a number of Shares for which such Grant could have been exercised immediately prior to such event.

(b) In addition to the foregoing provisions of Section 9 and 10(a), in the event of a Change in Control, (i) if determined by the Committee in the applicable Award agreement or otherwise at the time of the Change in Control, any outstanding Awards then held by Participants which are unexercisable or otherwise unvested or subject to lapse restrictions shall automatically be deemed exercisable or otherwise vested or no longer subject to lapse restrictions, as the case may be, as of immediately prior to such Change of Control and (ii) the Committee may (subject to Section 14(c) below), but shall not be obligated to, (A) accelerate, vest or cause the restrictions to lapse with respect to all or any portion of an Award, (B) cancel such Awards for fair value (as determined in the sole discretion of the Committee) which, in the case of Options and Stock Appreciation Rights, may equal the excess, if any, of value of the consideration to be paid in the Change in Control transaction to holders of the same number of Shares subject to such Options or Stock Appreciation Rights (or, if no consideration is paid in any such transaction, the Fair Market Value of the Shares subject to such Options or Stock Appreciation Rights) over the aggregate exercise price of such Options or Stock Appreciation Rights, (C) provide for the issuance of substitute Awards that will substantially preserve the otherwise applicable terms of any affected Awards previously granted hereunder as determined by the Committee in its sole discretion or (D) provide that for a period of at least ten (10) business days prior to the Change in Control, Options and Stock Appreciation Rights shall be exercisable as to all shares subject thereto and that upon the occurrence of the Change in Control, such Options and Stock Appreciation Rights shall terminate and be of no further force and effect.

10. No Right to Employment or Awards

The granting of an Award under the Plan shall impose no obligation on the Company or any Affiliate to continue the Employment of a Participant and shall not lessen or affect the Company's or Affiliate's right to terminate the Employment of such Participant. No Participant or other Person shall have any claim to be granted any Award, and there is no obligation for uniformity of treatment of Participants, or holders or beneficiaries of Awards. The terms and conditions of Awards and the Committee's determinations and interpretations with respect thereto need not be the same with respect to each Participant (whether or not such Participants are similarly situated).

11. Successors and Assigns

The Plan shall be binding on all successors and assigns of the Company and a Participant, including without limitation, the estate of such Participant and the executor, administrator or trustee of such estate, or any receiver or trustee in bankruptcy or representative of the Participants' creditors.

12. Nontransferability of Awards

Unless otherwise determined by the Committee, an Award shall not be transferable or assignable by the Participant otherwise than by will or by the laws of descent and distribution.

An Award exercisable after the death of a Participant may be exercised by the legatees, personal representatives or distributees of the Participant.

13. Amendment and Termination

(a) The Committee shall have the authority to make such amendments to any terms and conditions applicable to outstanding Grants as are consistent with this Plan provided that no such action shall modify any Grant in a manner adverse to the Participant without the Participant's consent except as such modification is provided for or contemplated in the terms of the Grant or this Plan (except that any adjustment that is made pursuant to Section 9 or 10 hereof may be made by the Committee in good faith).

(b) The Board may amend, suspend or terminate the Plan except that no such action, other than an action under Section 9 or 10 hereof, may be taken which would, without stockholder approval, increase the aggregate number of Shares available for Grants under the Plan, decrease the price of outstanding Grants, change the requirements relating to the Committee, extend the term of the Plan or be materially adverse to all Participants with respect to any outstanding Grants.

(c) Without limiting the generality of the foregoing, to the extent applicable, notwithstanding anything herein to the contrary, this Plan and Awards issued hereunder shall be interpreted in accordance with Section 409A of the Code and Department of Treasury regulations and other interpretative guidance issued thereunder, including without limitation any such regulations or other guidance that may be issued after the effective date of this Plan. Notwithstanding any provision of the Plan to the contrary, in the event that the Committee determines that any amounts payable hereunder will be taxable to a Participant under Section 409A of the Code and related Department of Treasury guidance prior to payment to such Participant of such amount, the Company may (a) adopt such amendments to the Plan and Awards and appropriate policies and procedures, including amendments and policies with retroactive effect, that the Committee determines necessary or appropriate to preserve the intended tax treatment of the benefits provided by the Plan and Awards hereunder and/or (b) take such other actions as the Committee determines necessary or appropriate to avoid the imposition of an additional tax under Section 409A of the Code.

14. Governing Law: Foreign Grants

(a) This Plan shall be governed by and construed in accordance with the laws of Delaware applicable therein.

(b) The Committee may make Grants to such persons and identified in Section 4(a) above who are subject to the laws of jurisdictions other than those of the United States, which Grants may have terms and conditions that differ from the terms thereof as provided elsewhere in the Plan for the purpose of complying with foreign laws or otherwise as deemed to be necessary or desirable by the Committee.

15. Withholding Taxes

The Company shall have the right to deduct from any cash payment made under the Plan any minimum federal, state or local income or other taxes required by law to be withheld with respect to such payment. It shall be a condition to the obligation of the Company to deliver Shares or cash under any Award where such delivery is a taxable event to the Participant that the Participant pay to the Company such amount as may be requested by the Company for the purpose of satisfying any liability for such minimum withholding taxes.

16. Effective Date and Termination Dates

The Plan, as amended and restated, shall be effective on and as of the date of its approval by the stockholders of the Company in accordance with applicable laws and shall terminate ten years later, subject to earlier termination by the Board pursuant to Section 14.

17. Choice of Law

The Plan shall be governed by and construed in accordance with the laws of the State of Delaware.

Approved by stockholders on November 6, 2008.

Sealy Corporation
Directors' Deferred Compensation Plan
(as amended and restated effective as of December 17, 2008)

Sealy Corporation

Directors' Deferred Compensation Plan

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ARTICLE I

DEFINITIONS

- 1.1. "Board" shall mean the Board of Directors of Sealy Corporation.
- 1.2. "Change in Control" shall mean (i) the sale of all or substantially all of the assets of the Company to an Unaffiliated Person (as defined below), (ii) a sale by the Company, Sealy Holding LLC (the "Investor") or any of their respective affiliates resulting in more than 50% of the voting stock of the Company being held by a person or group (as such terms are used in the Securities Exchange Act of 1934, as amended) that does not include the Investor or any of its respective affiliates, or (iii) a merger, consolidation, recapitalization or reorganization of the Company with or into an Unaffiliated Person; *if and only if* any such event listed in clauses (i) through (iii) above results in the inability of KKR Millennium Fund L.P. ("KKR"), the Investor, or any member or members of the Investor, to designate or elect a majority of the Board (or the board of directors of the resulting entity or its parent company). For purposes of this definition, the term "Unaffiliated Person" means any person or group who is not (x) KKR, the Investor or any member of the Investor, (y) an affiliate of KKR, the Investor or any member of the Investor, or (z) an entity in which KKR, the Investor, or any member of the Investor holds, directly or indirectly, a majority of the economic interests in such entity.
- 1.3. "Code" shall mean the Internal Revenue Code of 1986, as amended.
- 1.4. "Common Stock" shall mean the common stock of the Company.
- 1.5. "Company" shall mean Sealy Corporation.
- 1.6. "Director" shall mean a member of the Board who is not an employee of the Company or any of its subsidiaries.
- 1.7. "Fees" shall mean amounts earned for serving as a member of the Board, including any committees of the Board.
- 1.8. "He", "Him", or "His" shall apply equally to male and female members of the Board.
- 1.9. "Plan" shall mean this Directors' Deferred Compensation Plan, as it may be amended from time to time.
- 1.10. "Stock Account" shall mean the account created by the Company pursuant to Article III of this Plan in accordance with an election by a Director to receive stock compensation under Article II hereof.
- 1.11. "Stock Value" shall mean, for any given day, the closing price of the Company's Common Stock as reported on the New York Stock Exchange Inc. ("NYSE") Composite Tape on such day. If the closing price is not available from the NYSE for the Common Stock on a date in question, then the next preceding practicable date for which such closing price is available shall be used.
- 1.12. "Year" shall mean any calendar year.

ARTICLE II

ELECTION TO DEFER

2.1. A Director may elect, on or before December 31 of any Year, to irrevocably defer payment of all or a specified part of all Fees to be earned during the Year following the Year in which such election is made and succeeding Years (until the Director ceases to be a Director or elects (in writing) to change such election pursuant to Section 2.3 herein). Any person who shall become a Director during any Year, and who was not a Director of the Company on the preceding December 31 or otherwise an employee of the Company or any of its subsidiaries who participated in any other deferred compensation plan of the Company or any of its subsidiaries, may elect, before the Director's term begins (but in no event later than thirty (30) days after the date such person first becomes eligible to participate in this Plan), to defer payment of all or a specified part of such Fees earned during the remainder of such Year and for succeeding Years. Any Fees deferred pursuant to this Section 2.1 shall be paid to the Director at the time(s) and in the manner specified in Article IV hereof.

2.2. The election to participate in the Plan and manner and form of payment shall be designated by submitting a letter in the form attached hereto as Appendix A (the "Election Form") to the Secretary of the Company.

2.3. The election shall continue from Year to Year and become irrevocable on December 31 of each Year unless the Director changes or terminates it by written request delivered to the Secretary of the Company prior to December 31 of the Year preceding the commencement of the Year for which the change or termination is first effective. If the Director changes his existing election to defer Fees in order to receive Fees on a current basis, such Director may not subsequently reelect to defer payment of Fees for at least one Year.

ARTICLE III

DEFERRED COMPENSATION ACCOUNTS

3.1. The Company shall maintain separate memorandum accounts for the Fees deferred by each Director based on the elections each Director has made.

3.2. If a Director has elected to defer a portion of his Fees, the Company shall credit, on the date Fees become payable, the Stock Account of each Director with the number of shares of Common Stock which is equal to the deferred portion of any Fee due the Director as to which an election to defer Fees into the Stock Account has been made, divided by the Stock Value on the date such fees would otherwise have been paid. For purposes of this section 3.2, the Stock Value shall be determined on the date fees would otherwise have been paid.

3.3. The Company shall credit the Stock Account of each Director with the number of shares of Common Stock equal to any cash dividends (or the fair market value of dividends paid

in property other than dividends payable in Common Stock) payable on the number of shares of Common Stock represented in each Director's Stock Account divided by the Stock Value on the dividend payment date. Dividends payable in Common Stock will be credited to each Directors Stock Account in the form of the right to receive Common Stock. If adjustments are made to the outstanding shares Common Stock as a result of split-ups, recapitalizations, mergers, consolidations and the like, an appropriate adjustment also will be made in the number of shares of Common Stock credited to the Director's Stock Account.

3.4. Common Stock shall be computed to three decimal places.

3.5. The right to receive Common Stock at a later date shall not entitle any person to rights of a stockholder with respect to such Common Stock unless and until shares of Common Stock have been issued to such person pursuant to Article IV hereof.

3.6. The Company shall not be required to acquire, reserve, segregate, or otherwise set aside shares of its Common Stock for the payment of its obligations under the Plan, but shall make available as and when required a sufficient number of shares of its Common Stock to meet the needs of the Plan.

3.7. The Plan is intended to be a non-qualified, unfunded deferred compensation arrangement. Nothing contained herein shall be deemed to give a Director, a Director's beneficiary or any other person any interest in the assets of the Company or create any kind of fiduciary relationship between the Company and any person. To the extent that any person acquires a right to receive payments from the Company under the Plan, such right shall be no greater than the right of any unsecured general creditor of the Company.

ARTICLE IV

PAYMENT OF DEFERRED COMPENSATION

4.1. Subject to the second succeeding sentence, amounts contained in a Director's Stock Account shall be distributed as the Director's election (made pursuant to Section 2.2) shall provide. Subject to Section 6.3 below, distributions from the Director's Stock Account shall be paid in Common Stock or the cash equivalent thereof, at the election of the Company, and all such distributions shall begin on the first day of the Year following the later of the attainment of the Director's retirement date (as indicated in the Director's Election Form) or "separation from service" (within the meaning of Section 409A of the Code) with the Board.

4.2. Each Director shall have the right to designate one or more beneficiaries to succeed to his right to receive payments hereunder in the event of his death. No beneficiary designation shall be valid unless it is made in writing, signed by the Director and filed with the Secretary of the Company. [Notwithstanding anything herein to the contrary or in the Director's Election Form, in the event of the death of a Director, each designated beneficiary or, in the case of a failure of designation or the death of all designated beneficiaries without any designated successors, the Director's estate shall be entitled to receive, in the form in which such amounts would have otherwise been paid to the Director (as indicated on the Director's Election Form), any and all amounts contained in such Director's Stock Account in a lump sum payment no later than the later of (x)

December 31 of the Year in which the Director's death occurs and (y) ninety (90) days following the date of the Director's death. In the event such amounts are paid in cash (as provided in Section 4.1), then such amounts will be determined by multiplying the number of shares of Common Stock in the Director's Stock Account by the then Stock Value per share.][*Note to draft: confirm this is acceptable*]

ARTICLE V

ADMINISTRATION

5.1. The Company shall administer and interpret the Plan in its sole discretion and the Company shall maintain the Plan at its expense. All decisions made by the Company with respect to issues hereunder shall be final and binding on all parties.

5.2. Except to the extent required by law, the right of any Director or any beneficiary to any benefit or to any payment hereunder shall not be subject in any manner to attachment or other legal process for the debts of such Director or beneficiary; and any such benefit or payment shall not be subject to alienation, sale, transfer, assignment or encumbrance.

ARTICLE VI

AMENDMENT OF PLAN; GOVERNING LAW; CHANGE IN CONTROL

6.1. The Plan may be amended, suspended or terminated in whole or in part from time to time by the Board except that no amendment, suspension, or termination shall apply to the payment of any amounts previously credited to a Director's Stock Account.

6.2. The Plan shall be governed by and construed and enforced in accordance with the laws of the State of Delaware, without regard to principles of conflict of law.

6.3. Notwithstanding anything herein to the contrary, in the event of a Change in Control that is a "change in ownership or effective control" of the Company within the meaning of Section 409A of the Code, all amounts contained in each Director's Stock Account shall be distributed (in the same manner which such amounts would have otherwise been paid as indicated in the Director's election) within thirty (30) days after the occurrence of such Change in Control.

ARTICLE VII

SECTION 409A COMPLIANCE

7.1. Notwithstanding any other provisions of the Plan, no Fees shall be deferred, accelerated, extended, paid out or modified under this Plan in a manner that would result in the imposition of an additional tax under Section 409A of the Code.

7.2. In the event that is reasonably determined by the Board that, as a result of Section 409A of the Code, payments under the Plan may not be made at the time contemplated by the terms of the Plan without causing the Director to be subject to taxation under Section 409A of the Code, the Company will make such payment on the first day that would not result in Director incurring any tax liability under Section 409A of the Code; which, if the Director is a "specified employee" within the meaning of the Section 409A, shall be the

first day following the six-month period beginning on the date of the Director's separation from service. The Company shall have no liability to any Director for any failure to comply with Section 409A of the Code hereunder.

Adopted by Sealy Corporation and effective on the 17th day of December, 2008.

APPENDIX A

[Date]

Ken Walker
Secretary
Sealy Corporation
One Office Parkway
Trinity, North Carolina 27370

Dear Mr. _____ :

Pursuant to the Sealy Corporation Directors' Deferred Compensation Plan, dated as of _____, 200 (the "Plan"), I hereby elect to defer receipt of all or a portion of my Director's fees commencing 2005 and for succeeding calendar years in accordance with the percentages indicated below.

I elect to have my director's fees (and committee fees, if any) credited as follows (fill in appropriate percentages for options (a) and (b), below):

- (a) _____ % of the aggregate Director's fees shall be credited to my Stock Account as provided for in the Plan;
- (b) _____ % of the aggregate Director's fees shall not be deferred, but shall be paid to me directly as they accrue.

Further, I elect to receive any future payments to be made from my Stock Account in the following method (check one desired method below):

- _____ in one lump sum;
- _____ in _____ (insert number) equal annual installments.

I understand that my Stock Account will become payable on either the first day of the Year following or six months following (whichever is later) the later of the attainment of my "retirement date" (as indicated below) or separation from the Board. For this purpose,

I elect my retirement date to be attainment of age _____.

I further understand that, in any event, my Stock Account will become payable in the same manner as elected above within thirty (30) days after the occurrence of a Change in Control (as defined in the Plan).

In the event of my death prior to receipt of all or any amount of the balance of my Stock Account so accumulated, I designate the following one or more individuals as my beneficiary or beneficiaries to receive the funds so accumulated, but unpaid.

Very truly yours,

[Name]

[Witness]

THE AMENDED AND RESTATED SEALY CORPORATION BONUS PLAN

Sealy Corporation (the “Company”) hereby adopts the Amended and Restated Sealy Corporation Bonus Plan (the “Plan”) for the benefit of certain employees and subject to the terms and provisions set forth below.

1. **Purpose.** The Sealy Corporation Bonus Plan is intended to attract and retain employees in key positions of Sealy Corporation and selected subsidiaries (the “Company”), to motivate participants toward achieving the Company’s objectives and to reward participants for their contributions to the success of the Company.
2. **Administration.** The Plan is administered by the Board of Directors of the Company. The Board may delegate any of its rights and duties under the Plan to the Compensation Committee or an officer of the Company. The Board establishes administrative rules, determines employee eligibility, and establishes the awards to be made under the Plan and their terms and conditions. In addition, the Board has authority to adjust or modify the Plan or its operations to deal with unusual or unanticipated events in a fair and equitable manner. The Board shall construe and interpret the Plan and its determinations shall be final and binding upon all Plan participants.
3. **Participation.** Participants in the Plan are selected during each fiscal year by the Board from exempt salaried employees. Participants are assigned to a bonus group at the sole discretion of the Board, with groupings generally as follows:

- Group 8: Selected Senior Company Executives
- Group 7: Senior Company Executives
- Group 6: Corporate and Regional Sales & Operations Vice Presidents
- Group 5: Other Senior Management
- Group 4: Plant Managers, Sales Managers
- Group 3: Other Middle Management
- Group 2: Senior Professionals and Plant Supervisors
- Group 1: Selected Exempt Employees

Non-exempt employees (eligible for overtime) and Sales Representatives shall not participate in the Bonus Plan. Participation in the Plan in one year does not establish an employment relationship for a fixed duration and does not confer the right to continue in the employ of the Company or to participate in the Plan or any similar plan in any subsequent year. Participants may be added or have their bonus group changed during a fiscal year on a pro-rated basis at the discretion of the Board.

4. Amount of Award. Bonus awards under the Plan are based on the degree to which the financial performance of the Company, its operating plants, regions and selected subsidiaries meet the goals established for each fiscal year.

Individual awards under the Plan are based on the performance of the business segment (i.e., Company, division, plant and/or region) to which such participant is assigned. The percentage of salary used in the bonus award calculation for each Group increases from zero to a stated maximum as performance exceeds the minimum goal according to the following Schedule of Bonus Awards:

<u>GROUP</u>	<u>MINIMUM</u>	<u>TARGET</u>	<u>MAXIMUM</u>
8	(As determined by the Board for each participant)		
7	0%	35%	70%
6	0%	30%	60%
5	0%	25%	50%
4	0%	20%	40%
3	0%	15%	30%
2	0%	10%	20%
1	0%	5%	10%

Subject to section 5 below, bonus awards will be calculated as a percentage of a participant's weighted average annual rate of base salary in effect for the fiscal year for which a bonus is payable.

5. Special Circumstances. A participant's bonus award will be prorated based upon the number of days of active employment during the fiscal year under any of the following circumstances occurring during the fiscal year:

- a) The participant is hired or rehired after the beginning of the fiscal year, and on or before October 31st of the fiscal year;
- b) The participant terminates employment by reason of:
 - (1) Death,
 - (2) Long-term disability, or

- (3) Retirement (after attainment of age 65 or attainment of age 62 with 10 or more years of service), or
- c) The participant experiences a period of unpaid leave of absence (whether by layoff, workers compensation leave or other leave of absence) for a continuous period of 30 days or more.

A participant who is hired, transferred or promoted during the fiscal year will receive a prorated bonus based upon the number of days worked in each position and at each location/segment and in each bonus group. Hires, transfers, or promotions, which occur after October 31st, shall not take effect for bonus purposes until the following fiscal year.

Furthermore, if a participant terminates employment by reason set forth in Section 5(b), and if such termination occurs in the calendar year in which the fiscal year begins, the proration shall be applied to the participant's target percentage of his weighted average annual rate of base salary in effect for the fiscal year in which such termination occurs.

6. Goals. The performance goals for business segments will be based on corporate cash requirements, budgets, and expected results. One or more goals are defined annually for each business segment at the following achievement levels:

Maximum is the goal assigned to each segment that provides a bonus payout of two times the target payment amount.

Target is the goal assigned to each segment that provides a bonus payout at the target payment level.

Minimum is the goal assigned to each segment that must be achieved prior to any bonus payout for the segment.

Each year a communication will be issued to segment managers defining the corporate and segment goals and quantifying the achievement levels for each goal. Segment managers will receive a list of participants in their area and periodic updates on corporate and segment performance against goals.

Adjustments to goals may be provided for:

- a) Extraordinary Items as defined by APB 30, i.e. items which are "unusual in nature and infrequent in occurrence,"
- b) Any financial impact of new accounting pronouncements, and
- c) Any other items approved by the Board or the Compensation Committee.

7. Eligibility and Method of Payment of Award. In order to be eligible to receive a bonus payment for a given fiscal year, a participant must be hired on or before October 31st of the fiscal year and must remain employed by the Company through the last day of the fiscal year, unless employment is terminated by reason set forth in Section 5(b). All such bonus awards shall be paid in a single cash lump sum (less applicable withholding). All such bonus awards shall be paid on February 25 following the end of the fiscal year to which they relate, unless employment is terminated during the calendar year in which such fiscal year begins by reason set forth in Section 5(b). If termination is during the calendar year in which such fiscal year begins by reason set forth in Section 5(b), such bonus award shall be paid on February 25 following the end of such calendar year.

8. Amendment and Termination. The Plan was effective November 29, 1999 for fiscal years 2000 and beyond. As amended and restated herein, the Plan is effective December 1, 2008 for fiscal year 2009 and beyond. In addition, all bonus awards which relate to fiscal year 2008, unless employment terminated in calendar year 2007 by reason set forth in Section 5(b), shall be paid on February 25, 2009. No bonus awards which relate to fiscal year 2008 are payable for employments which terminated before 2008. The Board of Directors may amend, terminate or otherwise modify the Plan at any time.

IN WITNESS HEREOF, SEALY CORPORATION, by its appropriate officers duly authorized, has executed this instrument this 18th day of December, 2008.

SEALY CORPORATION

By: Kenneth L. Walker
Senior Vice President, General Counsel Title

By: Lawrence J. Rogers
President & CEO Title

SEALY
BENEFIT EQUALIZATION PLAN

Original Effective Date: December 1, 1994

Restatement Generally Effective: December 1, 2008

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AMENDMENT AND RESTATEMENT
OF THE
SEALY BENEFIT EQUALIZATION PLAN

This Amendment and Restatement of the Sealy Benefit Equalization Plan is hereby made by SEALY CORPORATION, a corporation organized and existing under and by virtue of the laws of the State of Delaware (the "Company");

WITNESSETH:

WHEREAS, the Company previously established an unfunded deferred compensation plan known as the Sealy Benefit Equalization Plan (the "Plan") to provide unfunded deferred compensation to a select group of management or highly compensated employees of Participating Companies; and

WHEREAS, it is desirable to amend and restate the Plan in order to comply with the provisions of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), and to make other desirable changes to the Plan; and

WHEREAS, the Board of Directors of the Company has approved adoption of such an amendment and restatement of the Plan by the Company;

NOW, THEREFORE, generally effective as of December 1, 2008, the Company hereby adopts an Amendment and Restatement to the Plan as follows:

ARTICLE I

PRELIMINARY PROVISIONS

1.1 Name. The name of this Plan was and shall remain the SEALY BENEFIT EQUALIZATION PLAN.

1.2 Effective Date. The Plan was established effective December 1, 1994.

1.3 Restatement Date. Except as otherwise stated herein, the provisions of the amended and restated Plan shall be December 1, 2008. Provisions required to be effective as of an earlier date shall be deemed effective as of such date.

1.4 Purpose. This Plan was established and is hereby amended and restated in order to provide unfunded deferred compensation to a select group of management or highly compensated employees of Participating Companies, under certain conditions specified in the Plan.

1.5 Plan for a Select Group. This Plan shall only cover employees of Participating Companies who are members of a “select group of management or highly compensated employees” as provided in Sections 201(2), 301(a)(3), 401(a)(1) and 4021(b)(6) of ERISA. Notwithstanding any apparently contrary provision of this Plan, this Plan shall be interpreted and administered in such a manner, and benefits hereunder shall be so limited, that this Plan shall be deemed to constitute such a plan.

1.6 Not a Funded Plan. It is the intention and purpose of the Company, other Participating Companies and Participants that this Plan shall be deemed to be “unfunded” for tax purposes as well as being such a plan as would properly be described as “unfunded” for purposes of Title I of ERISA. Notwithstanding any apparently contrary provision, this Plan shall be interpreted and administered in such a manner that it will be so deemed and would be so described.

1.7 Section 409A Compliance. It is the intention and purpose of the Company, other Participating Companies and Participants that this Plan shall be deemed at all relevant times to be in compliance with Section 409A of the Code and lawful guidance thereunder. Notwithstanding

any apparently contrary provision, this Plan shall be interpreted and administered in such manner, so that it will be so deemed. For periods on an after the effective date of Section 409A but prior to the Restatement Date, the Plan was administered in good faith compliance with Section 409A of the Code, but without a formal compliance amendment for that period, as permitted in applicable guidance.

ARTICLE II

DEFINITIONS

The use of neuter, masculine and feminine pronouns shall each be read to include the others and the use of the singular shall be read to include the plural and vice versa. Unless the context otherwise indicates, the following words, when initially capitalized, shall have the following meanings under this Plan:

2.1 Account. The word “Account” shall mean a “Deferred Compensation Account” established pursuant to Article V hereof.

2.2 Adoption Date. The words “Adoption Date” shall mean the date as of which the Company or a Subsidiary became or becomes a Participating Company under this Plan.

2.3 Affiliate. The word “Affiliate” shall mean any corporation which would be defined as a member of a controlled group of corporations which includes the Company or any business organization which would be defined as a trade or business (whether or not incorporated) which is under “common control” with the Company within the meaning of Sections 414(b) and (c) of the Code but, in each case, only during the periods any such corporation or business organization would be so defined.

2.4 Benefit Appeals Committee. The words “Benefit Appeals Committee” or “Committee” shall mean the Benefit Appeals Committee established pursuant to Article X of this Plan.

2.5 Board. The word “Board” shall mean the Board of Directors of the Company.

2.6 Breach of Noncompetition Requirement. The words “Breach of Noncompetition Requirement” shall mean the occurrence of an event in which a Participant, at any time prior to his payment in full hereunder:

(a) either while he is employed by the Company or any Subsidiary or after his Termination of Employment; and

(b) without the prior written permission of the Company; either directly or indirectly operates or performs any advisory or consulting services for, invests in (other than an investment in publicly traded stock of a corporation, provided that the ownership of such equity interest does not give the Participant the right to control or substantially influence the policy or operational decisions of such corporation), or otherwise becomes employed by or associated with, in any capacity, a Competitive Entity.

2.7 Cause. The word “Cause” shall mean for purposes of this Plan, either:

(a) the Participant’s willful violation of any written policies of the Company which violations are materially detrimental to the Company;

(b) the Participant’s conviction of (or written, voluntary and freely given confession to) a felony involving moral turpitude;

(c) the Participant’s conviction of (or written, voluntary and freely given confession to) a felony in connection with his employment;

(d) a Participant’s theft, fraud, embezzlement, material willful destruction of property (including any operating system of the Company or any Subsidiary or material disruption of the operations of the Company or any Subsidiary;

- (e) a Participant's being under the influence of illegal drugs or habitually under the influence of alcohol while on the job or on Company or any Subsidiary property;
- (f) a Participant's engaging in conduct, in or out of the workplace, which has a material adverse effect on the reputation or business prospects of the Company or one of its Subsidiaries;
- (g) a Participant's willfully engaging in conduct while an employee of the Company or any of its Subsidiaries which caused the Company or any of its Subsidiaries to be found, in a final judgment of a court of law, to have a material civil or criminal liability under any federal or state law;
- (h) a Participant's disclosure of trade secrets, customer lists or other confidential information if the Company or any Subsidiary has taken measures designed to prevent such disclosure; or
- (i) a Participant's Breach of the Noncompetition Requirement.

2.8 Change of Control. For purposes of this Plan, the words "Change of Control" shall mean a change of control of the Company of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, as in effect on the Restatement Date (the "Exchange Act"), whether or not the Company is then subject to such reporting requirements; provided, that, without limitation, a Change of Control shall be deemed to have occurred if:

- (a) any "person" (as defined in Sections 13(d) and 14(d) of the Exchange Act), other than KKR Millennium GP LLC and affiliates (collectively, "KKR"), becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing twenty percent (20%) or more of the combined voting power of the Company's then outstanding securities; provided that a Change of Control shall not be deemed to occur under this Subsection (a) by reason of (A) the acquisition of securities by the Company or an employee benefit plan (or any trust funding such a plan) maintained by the Company, or (B) while KKR continues to beneficially own more than fifty percent (50%) of the combined voting power of the Company's then outstanding securities;
- (b) during any period of one (1) year there shall cease to be a majority of the Board comprised of "Continuing Directors" as hereinafter defined; or

- (c) the stockholders of the Company (A) approve a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than eighty percent (80%) of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation, or (B) approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of more than fifty percent (50%) of the Company's assets.

For purposes of this Subsection 2.8(c), a sale of more than fifty percent (50%) of the Company's assets includes a sale of more than fifty percent (50%) of the aggregate value of the assets of the Company and its Subsidiaries or the sale of stock of one or more of the Company's Subsidiaries with an aggregate value in excess of fifty percent (50%) of the aggregate value of the Company and its Subsidiaries or any combination of methods by which more than fifty percent (50%) of the aggregate value of the Company and its Subsidiaries is sold.

- (d) For purposes of this Agreement, a "Change of Control" will be deemed to occur:
- (i) on the day on which a twenty percent (20%) or greater ownership interest described in Subsection 2.8(a) is acquired (or, if later, the day on which KKR ceases to beneficially own more than fifty percent (50%) of the combined voting power of the Company's then outstanding securities) provided that a subsequent increase in such ownership interest after it first equals or exceeds twenty percent (20%) shall not be deemed a separate Change of Control;
 - (ii) on the day on which "Continuing Directors," as hereinafter defined, cease to be a majority of the Board as described in Subsection 2.8(b);
 - (iii) on the day of a merger, consolidation or sale or disposition of assets as described in Subsection 2.8(c); or
 - (iv) on the day of the approval of a plan of complete liquidation as described in Subsection 2.8(c).

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- (e) For purposes of this Section 2.8, the word "Company" means Sealy Corporation, and, any other corporation or business organization in an unbroken chain of corporations or business organization ending with Sealy Corporation that owns, directly or indirectly, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock of Sealy Corporation other than KKR.
- (f) For purposes of this Section 2.8, the words "Continuing Directors" mean individuals who at the beginning of any period (not including any period prior to the Restatement Date) of one (1) year constitute the Board and any new director(s) whose election by the Board or nomination for election by the Company's stockholders was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved.

2.9 Code. The word "Code" shall mean the Internal Revenue Code of 1986, as such may be amended from time to time, and lawful guidance promulgated thereunder. Whenever a reference is made to a specific Code Section, such reference shall be deemed to include any successor Code Section having the same or a similar purpose.

2.10 Company. The word "Company" shall mean Sealy Corporation, a Delaware corporation, and any successor corporation or business organization which shall assume the duties and obligations of Sealy Corporation by operation of law or otherwise under this Plan.

2.11 Compensation. The word "Compensation" shall mean with respect to a Participant for a Plan Year, his Profit Sharing Plan Compensation, determined without regard to the limitation of Section 401(a)(17) of the Code, which is in excess of (a) below but which is not in excess of (b) below, where:

- (a) is the limitation in effect for such period pursuant to Section 401(a)(17) of the Code; and
- (b) is the limitation that would be in effect for such period if the Two Hundred Thousand Dollar (\$200,000.00) compensation limitation amount and cost of

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living method as set forth in Section 401(a)(17) of the Code as in effect for plan years of tax-qualified retirement plans beginning in 1993 had not been amended effective at any time thereafter (and, for avoidance of doubt, which limitation for plan years of tax-qualified retirement plans beginning in 1993 was Two Hundred Thirty-Five Thousand Eight Hundred Forty Dollars (\$235,840.00)).

Therefore, it is intended that Compensation at any time for purposes of this Plan shall be that band of Profit Sharing Plan Compensation between the then applicable limit of Section 401(a)(17) and what the limit then would have been had Section 401(a)(17) of the Code not been amended as referred to Subsection 2.11(b). The amount of a Participant's Compensation for any Plan Year shall be determined as of the last day of such year.

2.12 Compensation Committee. The words "Compensation Committee" shall mean the Compensation Committee of the Board or its successor as determined by the Board. If the Compensation Committee has no successor, the duties of the Compensation Committee shall become duties of the Board. The Compensation Committee shall have such duties with respect to the Plan as shall be determined by the Board.

2.13 Competitive Entity. The words "Competitive Entity" shall mean any of the following mattress manufacturing companies in the United States or their mattress manufacturing or mattress wholesaling affiliates: Simmons, Serta, Spring Air, Kingsdown, Select Comfort and Tempur-Pedic or any of their successors or any other mattress manufacturing company or its mattress manufacturing or mattress wholesaling affiliate which represents 10% or more of the mattress market in the United States.

Notwithstanding anything in this Section to the contrary, a company, partnership, organization, proprietorship, or other entity which purchases the stock or assets of a business unit directly from the Company or any Subsidiary shall not be deemed a Competitive Entity solely with

respect to the products developed, manufactured, prepared, sold, or distributed by and the individuals employed by such business unit as of the date of such stock or asset purchase.

- 2.14 Covered Employee. The words “Covered Employee” shall mean an Employee of a Participating Company who:
- (a) is an “active participant” in the Profit Sharing Plan as the term “active participant” is defined in that plan;
 - (b) receives remuneration from one or more Participating Companies at a rate which, in the aggregate for a Plan Year, would exceed the limit on Profit Sharing Plan Compensation which may be taken into account by a tax qualified retirement plan in accordance with Section 401(a)(17) of the Code;
 - (c) is a senior management employee of a Participating Company, as determined by the Plan Administrator;
 - (d) is a member of “a select group of management or highly compensated employees” as described in Section 1.5 of this Plan;
 - (e) is not a nonresident alien Employee who receives no earned income (within the meaning of Code Section 911(d)(2)) from a Participant Company or any Affiliate that constitutes income from sources within the United States (within the meaning of Code Section 861(a)(3)), except to the extent expressly permitted by this Plan; and
 - (f) is not employed in a capacity reasonably categorized by the Company, a Participating Company or an Affiliate as a Leased Person, regardless of whether his status under the Code subsequently may be determined by a court, the Internal Revenue Service or other government entity to be a Covered Employee, an Employee or otherwise.

An Employee shall become a Covered Employee as of the first day on which he satisfies all of the requirements of Subsections 2.14(a) through (f) above. An Employee shall cease to be a Covered Employee as of the first day thereafter on which he ceases to satisfy any one of such requirements. With respect to the requirement in Subsection 2.14(b) relating to remuneration, an Employee will be deemed to first satisfy such requirement on the first day as of which his rate of remuneration exceeds the limits referred to in Subsection 2.14(b) relating to remuneration; an

Employee will be deemed to cease to satisfy such requirement on the last day of the first Plan Year for which his remuneration is not so limited.

2.15 Date of Hire. The words “Date of Hire” shall mean an Employee’s Date of Hire for purposes of the Profit Sharing Plan.

2.16 Deferred Compensation Account. The words “Deferred Compensation Account” shall mean for each Participant the bookkeeping account maintained on his behalf to reflect hypothetical profit sharing contributions made on his behalf and all hypothetical investment earnings and losses thereon.

2.17 Disability. The word “Disability” shall mean (and the word “Disabled” shall relate to) a disability as determined for purposes of the Profit Sharing Plan.

2.18 Effective Date. The words “Effective Date” shall mean the original effective date of this Plan which is December 1, 1994.

2.19 Employee. The word “Employee” shall mean any common law employee or Leased Person of a Participating Company or an Affiliate. The word “Employee” shall not include any person who renders service to a Participating Company or an Affiliate solely as a director or independent contractor. In the event a person renders service to a Participating Company or an Affiliate as a common law employee and in another capacity as a director, an independent contractor or otherwise as a self-employed individual, he shall be considered to be an Employee hereunder only in his capacity as a common law employee.

In the event a person who was not classified by a Participating Company or an Affiliate as a common law employee is subsequently determined by a court, the Internal Revenue Service or other governmental entity to be a common law employee, such person shall only be considered to be an Employee hereunder prospectively from the date of such determination, or, if later, at the time that

such person is initially treated as an Employee on the payroll records of the Participating Company or Affiliate.

2.20 ERISA. The acronym “ERISA” shall mean the Employee Retirement Income Security Act of 1974, as amended, and lawful guidance promulgated thereunder. Whenever a reference is made to a specific ERISA Section, such reference shall be deemed to include any successor ERISA Section having the same or a similar purpose.

2.21 Leased Person. The words “Leased Person” shall mean, on and after December 1, 1997, any individual who, pursuant to an agreement between any Participating Company or Affiliate and any leasing organization, has performed services for the Participating Company, for an Affiliate or for related persons, as determined in accordance with Code Section 414(n)(6), on a substantially full time basis for a period of at least one (1) year; provided, however, that such services are performed under the primary direction or control of the Participating Company or the Affiliate.

In the event a person who was not classified by a Participating Company or an Affiliate as a Leased Person is subsequently determined by a court, the Internal Revenue Service or other governmental entity to be a Leased Person, such person shall only be considered to be a Leased Person hereunder prospectively from the date of such determination, or, if later, at the time that such person is initially treated as a Leased Person by a Participating Company or an Affiliate.

2.22 Normal Retirement Age. The words “Normal Retirement Age” shall mean a Participant’s Normal Retirement Age as determined for purposes of the Profit Sharing Plan.

2.23 Participant. The word “Participant” shall mean a Covered Employee who becomes a Participant in this Plan pursuant to Article III hereof. A Participant shall cease to be a Participant upon his Termination of Employment. A Participant may be categorized as one of the following:

- (a) In general, a Participant will be an Active Participant;
- (b) If he ceases to be a Covered Employee but does not incur a Termination of Employment, he will be considered an Inactive Participant; and
- (c) If he has a Termination of Employment, he will be considered a former Participant.

2.24 Participating Company. The words “Participating Company” shall mean the Company and any Subsidiary which is a Participating Company pursuant to the provision of Article XII of this Plan. The Participating Company as of the Restatement Date is listed in Article XII of this Plan.

2.25 Plan. The word “Plan” shall mean the Sealy Benefit Equalization Plan, as previously established and amended, as set forth herein, and as it later may be amended.

2.26 Plan Administrator. The words “Plan Administrator” shall mean Sealy, Inc., an Ohio corporation, or such successor as may be appointed by the Board.

2.27 Plan Year. The words “Plan Year” shall mean the twelve (12) month period commencing on December 1 and ending on the following November 30. The Plan Year of this Plan shall correspond to the plan year of the Profit Sharing Plan.

2.28 Profit Sharing Plan. The words “Profit Sharing Plan” shall mean the Sealy Profit Sharing Plan.

2.29 Profit Sharing Plan Compensation. The words “Profit Sharing Plan Compensation” shall mean, with respect to a Participant in this Plan for a Plan Year, his “compensation” (as that word is defined in the Profit Sharing Plan) for such Plan Year, but without regard to the dollar limitations on such compensation pursuant to Section 401(a)(17) of the Code. The amount of a Participant’s Profit Sharing Plan Compensation for any Plan Year shall be determined as of the last day of such year.

2.30 Separation from Service. The words “Separation from Service” shall mean a “separation from service” as defined for purposes of Section 409A of the Code for purposes of determining when a distribution may be made under the terms of a non-qualified deferred compensation plan such as this Plan. In general, a Separation from Service for purposes of this Plan occurs when there is a good faith severance of the employment relationship between the Company and its Affiliates and an Employee due to the Employee’s death, retirement or other “termination of employment” (as that term is defined for purposes of identifying a Separation from Service for purposes of Section 409A). Specifically, the following shall apply:

- (a) An Employee will not be deemed to have a Separation from Service while on military leave, sick leave, or other bona fide (i.e., where there is a reasonable expectation that the Employee will return) leave of absence if the period of such leave does not exceed six (6) months, or, if longer, so long as the Employee retains a right to reemployment with the Company or an Affiliate by law or contract. If the leave exceeds six (6) months and the Employee does not retain such a reemployment right, the Separation from Service occurs on the first day following such six (6) months. However, where the leave is due to any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than six (6) months, where such impairment causes the Employee to be unable to perform the duties of his or her position of employment or any substantially similar position of employment, twenty-nine (29) months will be substituted for six (6) months for purposes of this Subsection;
- (b) An Employee will not be considered to have a Separation from Service merely due to transfer between Employee and independent contractor status (including status as a director of the Company);
- (c) Whether a “termination of employment,” as defined for purposes of the definition of Separation from Service under Section 409A of the Code, has occurred is determined based on whether the facts and circumstances indicate that the applicable Participating Company or Affiliate and the Employee reasonably anticipated that:
 - (i) no further services would be performed after a certain date; or
 - (ii) that the level of bona fide services the Employee would perform after such date (whether as an Employee or independent contractor,

including as a director) would permanently decrease to less than fifty percent (50%) of the average level of bona fide services provided in the immediately preceding thirty-six (36) months.

This Plan contains definitions of both the words "Termination of Employment" and the words "Separation from Service." The definition of Termination of Employment is the same as the definition in the Profit Sharing Plan with the intent of providing, to the extent possible, parallel treatment of individuals who participate in both plans. The term Separation from Service is contained in this Plan, but not the Profit Sharing Plan, because a Termination of Employment which results in a distribution event under the Profit Sharing Plan may not constitute a Separation from Service which is permitted to result in a distribution from this Plan pursuant to the restrictions of Section 409A of the Code. For example, if an Employee were to retire from the Company and thereby incur a Termination of Employment but become an independent contractor of the Company:

- (x) the individual may be eligible for a distribution from the Profit Sharing Plan (under the rules in effect as of the Restatement Date); but
- (y) the individual may not be eligible for a distribution from this Plan depending on the level of services the Participant is expected to perform as an independent contractor.

2.31 Subsidiary. The word "Subsidiary" shall mean any corporation in which the Company owns, directly or indirectly, stock possessing at least eighty percent (80%) or more of the total combined voting power of all classes of stock entitled to vote or at least eighty percent (80%) of the total value of shares of all classes of stock of such corporation, as determined pursuant to Section 1563(a)(1) of the Code, but only during the period any such corporation would be so defined.

2.32 Termination of Employment. The words "Termination of Employment" shall mean for any Employee the occurrence of a termination of employment as defined in the Profit Sharing Plan.

See the definition of the words "Separation from Service."

2.33 Vested Interest. The words "Vested Interest" shall mean with respect to any Participant (a) minus (b), where:

- (a) equals the sum of:
 - (i) his Deferred Compensation Account multiplied by his Vested Percentage; plus
 - (ii) any distributions made to the Participant from his Deferred Compensation Account since his earliest Date of Hire which has not been followed by five (5) consecutive One (1) Year Breaks-In-Service, multiplied by his Vested Percentage; and
- (b) equals the amount of any distributions made to the Participant from his Deferred Compensation Account since his earliest Date of Hire which has not been followed by five (5) consecutive One (1) Year Breaks-In-Service.

2.34 Vested Percentage. The words "Vested Percentage" shall mean for any Participant a percentage determined on the basis of his number of years of Vesting Service in accordance with the following table and shall be the same as his Vested Percentage under the Profit Sharing Plan except as otherwise provided in this Section:

<u>Years of Vesting Service</u>	<u>Vested Percentage</u>
Less than 2 years	0%
2 but less than 3 years	20%
3 but less than 4 years	40%
4 but less than 5 years	60%
5 but less than 6 years	80%
6 or more years	100%

Notwithstanding the foregoing provisions of this Section 2.34, the Vested Percentage of a Participant shall be zero percent (0%) in each of the following circumstances:

- (a) if his employment is terminated for Cause;
- (b) if he engages in a Breach of the Noncompetition Requirement; or

- (c) until the last day of the first Plan Year following the Plan Year in which the Participant's Account first is allocated a hypothetical contribution under this Plan (which for this purpose of determining the Participant's Vested Percentage will be considered the date the limited contribution to the Profit Sharing Plan actually is made); and

shall be one hundred percent (100%) if (subject to Subsection (c) above), the Participant dies, becomes Disabled or attains his Normal Retirement Age before he incurs a Termination of Employment.

- 2.35 Vesting Service. The words "Vesting Service" shall mean for any Employee his vesting service as determined under the Profit Sharing Plan.

ARTICLE III

ELIGIBILITY AND PARTICIPATION

3.1 Eligibility. Each Employee who is or becomes a Covered Employee shall be eligible to become a Participant under this Plan.

3.2 Participation. A Covered Employee who was a Participant on the Restatement Date shall continue to be a Participant. On and after the Restatement Date, an Employee who satisfies the eligibility requirements of Section 3.1 hereof shall commence participation for the first Plan Year for which his Account receives the allocation of a hypothetical contribution which generally shall be as of the later to occur of:

- (a) the first day of the first Plan Year coincident with or next following the date as of which he becomes a participant in the Profit Sharing Plan; or
- (b) the first day of the first Plan Year in which his rate of Profit Sharing Plan Compensation is projected to exceed the limits of Section 401(a)(17) of the Code.

3.3 Cessation of Participation. A Participant shall cease to be a Participant and shall become a former Participant, as of his Termination of Employment.

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3.4 Inactive Participants. If a Participant ceases to be a Covered Employee (because he ceases to be a member of a select group of management or highly compensated employees or for any other reason), but remains an Employee, he shall cease to be an Active Participant and shall become an Inactive Participant.

3.5 Rehired Covered Employee. In the event that a Participating Company or an Affiliate shall reemploy a former Participant, he shall be eligible to become a Participant in the Plan as if he were a new Employee, subject to the restrictions of Section 409A of the Code.

ARTICLE IV

PROFIT SHARING CONTRIBUTIONS

4.1 Active Participants. If a Participating Company makes a discretionary profit sharing contribution to the Profit Sharing Plan for a plan year of the Profit Sharing Plan which corresponds to a Plan Year of this Plan, and:

- (a) if an Active Participant in this Plan is also a participant in such Profit Sharing Plan for such plan year; and
- (b) if such Active Participant's account under the Profit Sharing Plan is entitled to share in the allocation of such contribution; and
- (c) if the allocation to such Active Participant's account under the Profit Sharing Plan is limited due to the limitation on remuneration which may be taken into account for purposes of tax qualified retirement plans under Section 401(a)(17) of the Code; then

a hypothetical amount shall be allocated to such Active Participant's Account hereunder for the corresponding Plan Year under this Plan. The amount so allocated to the Participant's Account under this Plan shall be the same percentage of such Active Participant's Compensation for the Plan Year under this Plan as his allocation under the Profit Sharing Plan is a percentage of his

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Profit Sharing Compensation (as limited pursuant to Section 401(a)(17) of the Code) for the corresponding plan year of the Profit Sharing Plan.

4.2 Inactive and Former Participants. A Participant shall not be entitled to have any hypothetical contribution allocated to his Account under this Plan for any period during which he is an Inactive Participant or a former Participant. However, this rule shall not prohibit (for example) the Account of a former Participant who incurs a Termination of Employment from receiving an allocation under this Plan for his period of active participation during such year of termination if the requirements of Section 4.1 are satisfied.

ARTICLE V

ACCOUNTS

5.1 Establishment of Accounts. The Plan Administrator shall establish a Deferred Compensation Account in its books and records in the name of each Participant in this Plan. All hypothetical amounts credited to the Account of any Active Participant, Inactive Participant or former Participant shall constitute a general, unsecured liability of the Participating Companies to such person.

5.2 Allocation of Contributions. Hypothetical amounts contributed on behalf of a Participant pursuant to Section 4.1 hereof shall be allocated to such Participant's Account.

5.3 Crediting of Earnings. The Plan Administrator shall credit the Account of each Active Participant, each Inactive Participant and each former Participant who has not yet been paid his Account balance hereunder, with hypothetical earnings and losses for the Plan Year or other appropriate period equal to the return on the investment in the Participant's accounts under the Profit Sharing Plan for such corresponding Plan Year or other period. In determining such return and applying it to the Plan, the Plan Administrator may use rules of administrative convenience

provided that the rate of return credited to the Participant's Account under the Plan is roughly equal to his rate of return under the Profit Sharing Plan. For purposes of crediting earnings and losses with respect to a hypothetical contribution under this Plan, such contribution shall be deemed credited to such Active Participant's Account under this Plan as of the date the actual contribution is allocated to his account under the Profit Sharing Plan. If the Participant has no amount in the Profit Sharing Plan for a period (e.g. if his Profit Sharing Plan accounts are distributed before he receives his distribution under this Plan), his hypothetical investment return under this Plan for such period will be based on the return of the Profit Sharing Plan fund most protective of principal for that period.

ARTICLE VI

PAYMENTS AND BENEFITS

6.1 Plan Distributions. Plan distributions shall be subject to the provisions of this Section 6.1 as follows:

- (a) Subject to the provisions of Subsection 6.1(b) hereof:
 - (i) A Participant who retires or otherwise incurs a Separation from Service on or after his Normal Retirement Date shall be entitled to receive a distribution of his Account balance;
 - (ii) A Participant who incurs a Separation from Service due to his Disability shall be entitled to receive a distribution of his Account balance;
 - (iii) The beneficiary of a Participant who incurs a Separation from Service due to his death shall be entitled to receive a distribution of the deceased Participant's Account balance; and
 - (iv) A Participant who incurs a Separation from Service prior to attainment of his Normal Retirement Age shall be entitled to receive a distribution of his Vested Interest.

- (b) The provisions of Subsection 6.1(a) shall be subject to the following provisions of this Subsection 6.1(b):
 - (i) A Participant who receives a distribution of his Vested Interest, which Vested Interest is less than One Hundred Percent (100%), shall forfeit the remainder of his Account balance at the time of distribution; and
 - (ii) A Participant who either incurs a Separation from Service for Cause or who engages in a Breach of the Noncompetition Requirement prior to distribution of his Account balance or Vested Interest, as applicable, shall forfeit his Account balance.
- (c) Forfeitures shall be dealt with as provided in Section 6.2.
- (d) Distribution shall be made at the time and in the manner described in Sections 6.3 and 6.4, respectively.

6.2 Forfeitures. A Participant's Account shall be debited by the amount of any forfeiture. Forfeitures shall not be allocated to the Accounts of other Participants.

6.3 Time of Distribution. Distributions pursuant to Section 6.1 shall be made at such time as the Plan Administrator, in its sole discretion, shall determine, but not earlier than, nor more than ninety (90) days later than, the applicable date set forth below:

- (a) If the distribution is due to any reason other than the Participant's death, the applicable date is the date which is the earlier of:
 - (i) the day which is six (6) months and one (1) day following the date of the Participant's Separation from Service; or
 - (ii) the date which is thirty (30) days following the date of the Participant's death if such date is later than the date of such Participant's Separation from Service but earlier than the day which is six (6) months and one (1) day following the date of such Separation from Service; or
- (b) If the distribution is due to the Participant's death, the applicable date is the date which is thirty (30) days following the date of the Participant's death.

6.4 Form of Distribution. Subject to such rules, procedures, limits and restrictions as the Plan Administrator may establish from time to time, a Participant or a beneficiary of a deceased

Participant shall receive any distribution resulting from the Participant's Separation from Service or death, as applicable, in the form of a single sum payment, subject to appropriate withholding.

6.5 No Suspension of Benefits. As of the Restatement Date, it appears that Section 409A of the Code does not permit a "suspension of benefits" on rehire. Therefore, unless otherwise required by Section 409A, if a Participant has a bona fide Separation from Service, the distribution resulting from such Separation from Service shall not be suspended merely because the Participant is rehired before the distribution is made.

6.6 Specified Employee Payment Delay. It is intended that all distributions under this Plan, regardless of whether the recipient is a "Specified Employee" as described in Section 409A or the Company's Specified Employee Policy, will be delayed as required for Specified Employees pursuant to Section 6.3 hereof or as otherwise required to comply with Section 409A of the Code and the Company's Specified Employee Policy.

ARTICLE VII

BENEFICIARIES

7.1 Beneficiary Designation. Subject to rules and procedures promulgated by the Plan Administrator, a Participant or former Participant may sign a document designating a beneficiary or beneficiaries to receive any amounts payable under this Plan due to his death. In the event that a Participant or former Participant fails to designate a beneficiary in accordance with the provisions of this Section 7.1, his beneficiary shall be deemed to be the person or persons in the first of the following classes in which there are any survivors of the Participant or former Participant:

- (a) his spouse at the time of his death;
- (b) his issue per stirpes; and
- (c) the executor or administrator of his estate.

ARTICLE VIII

RIGHTS OF PARTICIPANTS

8.1 Creditor Status of Participants. The hypothetical profit sharing contributions made on behalf of a Participant hereunder shall be merely unfunded, unsecured promises of, and joint and several obligations of, the Participating Companies to make benefit payments in the future and shall be liabilities solely against the general assets of the Participating Companies. The Company and the other Participating Companies shall not be required to segregate, set aside or escrow actual amounts to reflect the hypothetical profit sharing contributions nor any hypothetical earnings credited thereon. With respect to the hypothetical amounts credited to any Accounts hereunder and any benefits payable hereunder, a Participant and his beneficiary shall have the status of general unsecured creditors of the Participating Companies, and may look only to the Participating Companies and their general assets for payment of any such amounts credited to a Participant's Account.

The liability of a Participating Company with respect to Participants other than its own Employees and former Employees shall be limited to the extent necessary to prevent this Plan from being considered other than unfunded as described in Section 1.6 of this Plan or from otherwise adversely affecting the status of this Plan as described in Article I hereof. Without limiting the generality of the foregoing, as of the Restatement Date, it appears that the liability for amounts accrued with respect to Employees of another Participating Company would extend to hypothetical contributions but not earnings and only for hypothetical contributions accrued while the Participating Company was an Affiliate of the Participating Company by which the Participant was employed and only while it remains an Affiliate.

ARTICLE IX

NON-ALIENATION

9.1 Non-Alienation. No benefits or hypothetical amounts credited to Accounts under this Plan shall be subject in any manner to be anticipated, alienated, sold, transferred, assigned, pledged, encumbered, attached, garnished or charged in any manner (either at law or in equity), and any attempt to so anticipate, alienate, sell, transfer, assign, pledge, encumber, attach, garnish or charge the same shall be void; nor shall any such benefits or amounts in any manner be liable for or subject to the debts, contracts, liabilities, engagements or torts of the person entitled to such benefits as are herein provided for her or him. Notwithstanding the foregoing provisions of this Section to the contrary, the Plan Administrator shall comply with a qualified domestic relations order to the extent permitted under Section 409A of the Code. In furtherance thereof, the Plan Administrator shall establish a procedure with respect to such orders.

ARTICLE X

ADMINISTRATION

10.1 Appointment of Plan Administrator. The Board of Directors of the Company shall appoint the Plan Administrator which shall be any person(s), corporation or partnership, (including the Company itself) as said Board of Directors shall deem desirable in its sole discretion. The Plan Administrator may be removed or resign upon thirty (30) days' written notice or such lesser period of notice as is mutually agreeable. Unless the Board of Directors appoints another Plan Administrator, Sealy, Inc. shall be the Plan Administrator.

10.2 Powers and Duties of the Plan Administrator. Except as expressly otherwise set forth herein, the Plan Administrator shall have the authority and responsibility granted or imposed on an "administrator" by ERISA. The Plan Administrator shall determine any and all questions of fact, resolve all questions of interpretation of this Plan which may arise under any of the provisions

of this Plan as to which no other provision for determination is made hereunder, and exercise all other powers and discretions necessary to be exercised under the terms of this Plan which it is herein given or for which no contrary provision is made. The Plan Administrator shall have full power and discretion to interpret this Plan and related documents, to resolve ambiguities, inconsistencies and omissions, to determine any question of fact, and to determine the rights and benefits, if any, of any Participant or other applicant, in accordance with the provisions of this Plan. Subject to the provisions of any claims procedure hereunder, the Plan Administrator's decision with respect to any matter shall be final and binding on all parties concerned, and neither the Plan Administrator nor any of its directors, officers, employees or delegates nor, where applicable, the directors, officers or employees of any delegate, shall be liable in that regard except for gross abuse of the discretion given it and them under the terms of this Plan. All determinations of the Plan Administrator shall be made in a uniform, consistent and nondiscriminatory manner with respect to all Participants and beneficiaries in similar circumstances. The Plan Administrator, from time to time, may designate one or more persons or agents to carry out any or all of its duties hereunder.

10.3 Engagement of Advisors. The Plan Administrator may employ actuaries, attorneys, accountants, brokers, employee benefit consultants, and other specialists to render advice concerning any responsibility the Plan Administrator or Committee has under this Plan. Such persons may also be advisors to any Participating Company.

10.4 Payment of Costs and Expenses. The costs and expenses incurred in the administration of this Plan shall be paid by one or more of the Participating Companies, as determined by the Company. Such costs and expenses include those incident to the performance of the responsibilities of the Plan Administrator or Committee, including but not limited to, claims administration fees and costs, fees of accountants, legal counsel and other specialists, bonding expenses, and other costs of administering this Plan. Notwithstanding the foregoing, in no event

will any person serving in the capacity of Plan Administrator, or Committee member who is a full-time employee of a Participating Company be entitled to any compensation for such services.

10.5 Claims Procedure. The Plan Administrator shall establish and maintain a claims procedure under the Plan and shall establish and appoint the members of a Benefit Appeals Committee with appropriate powers in connection therewith.

10.6 Limitation of Liability. Except as otherwise provided in ERISA, the Plan Administrator and the Committee, and their respective officers, employees and members, and directors, officers and employees of the Company, the Participating Subsidiaries and Affiliates, shall incur no personal liability of any nature whatsoever in connection with any act done or omitted to be done in the administration of this Plan. No person shall be liable for the act of any other person.

ARTICLE XI

AMENDMENT AND TERMINATION

11.1 Power to Amend or Terminate. Except as otherwise provided in this Section following a Change of Control, this Plan may be amended by the Company at any time, or from time to time, including an amendment to cease contributions hereunder, and (except as otherwise provided in Section 11.2 hereof) may be terminated by the Company at any time, but no such amendment, modification or termination shall reduce a Participant's Vested Interest, determined as of the date of such amendment, modification or termination. Such amendment, modification or termination shall be in writing, executed by one or more officers of the Company who are authorized to do so. This Plan may not be amended (but except as otherwise provided in Section 11.2 hereof may be terminated) during the two (2) year period following a Change of Control except that amendments may be made as required by law.

11.2 Restrictions on Plan Termination. If this Plan is terminated then, on and after the effective date of such termination, all deferrals hereunder shall cease. Thereafter, all amounts then credited to each Participant's Accounts shall become fully vested. Distributions as a result of such plan termination, which shall be in the form of a single sum payment, shall be made only in compliance with the requirements of Section 409A of the Code concerning plan terminations and liquidations (or any successor provision governing permitted distributions upon a plan termination and liquidation). For illustrative purposes only, the general conditions under which distributions upon plan terminations and liquidations are permitted under such Section 409A are described as follows:

- (a) within 12 months of certain corporate dissolutions or with the approval of the bankruptcy court;
- (b) in connection with a change in control event (as defined pursuant to Section 409A of the Code); or
- (c) if the Participant's employer terminates all nonqualified deferred compensation plans that would be aggregated, under Section 409A of the Code, with any terminated plan or agreement for at least three (3) years, and Plan termination distributions are made after twelve (12) months, but within twenty-four (24) months, of Plan termination.

11.3 No Liability for Plan Amendment or Termination. Neither the Company, nor any other Participating Company, nor any officer, Employee or director thereof shall have any liability because this Plan is amended or terminated. Without limiting the generality of the foregoing, none of the foregoing shall have any liability due to the Company discontinuing hypothetical contributions under this Plan or terminating this Plan notwithstanding the fact that a Participant may have expected to have benefited from future hypothetical contributions or earnings hereunder had this Plan remained in effect without such discontinuance of hypothetical contributions or such termination.

ARTICLE XII

PARTICIPATING COMPANIES

12.1 Initial Participating Company. The initial Participating Company and its Adoption Date is as follows:

<u>Participating Company</u>	<u>Adoption Date</u>
Sealy, Inc.	December 1, 1994

12.2 Designation of Participating Companies. A Subsidiary of the Company will become a Participating Company under this Plan as of the date an Employee of that Subsidiary becomes a Covered Employee. Such a Subsidiary's status as a Participating Company may be reflected by an amendment to Section 12.1 hereof which specifies the name of the Subsidiary and its Adoption Date, but such an amendment shall not be required in order for the Subsidiary to be a Participating Company. Any such amendment need only be executed by the Company.

12.3 Adoption of Supplements. The Company may determine that special provisions shall be applicable to some or all of the Employees of a Participating Company, either in addition to or in lieu of the provisions of this Plan, or may determine that certain Employees otherwise eligible to participate in this Plan shall not be eligible to participate in this Plan. In such event, the Company shall adopt a Supplement with respect to the Participating Company which employs such individuals which Supplement shall specify the Employees of the Participating Company covered thereby and the special provisions applicable to such Employees. Any Supplement shall be deemed to be a part of this Plan solely with respect to the Employees specified therein.

12.4 Amendment of Supplements. The Company, from time to time, may amend, modify or terminate any Supplement; provided, however, that no such action shall operate so as to deprive any Employee who was covered by such Supplement of his Vested Interest as of the date of such

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amendment or termination. Any such amendment or termination shall be subject to the Plan's general rules with respect to amendment or termination of the Plan.

12.5 Termination of Participation of Participating Company. The Company may terminate the status of a Subsidiary as a Participating Company at any time by administrative action or such status may be terminated by events, as when a Participating Company ceases to be a Subsidiary. Distribution of the Accounts of Participants employed by said Participating Company shall continue to be subject to the provisions of this Plan unless special provision, permitted by law, shall be made therefor.

12.6 Delegation of Authority. The Company is hereby fully empowered to act on behalf of itself and the other Participating Companies as it may deem appropriate in maintaining the Plan. Without limiting the generality of the foregoing, such actions include obtaining and retaining the status of the Plan as described in Article I of the Plan and appointing attorneys-in-fact in pursuit thereof. Furthermore, the adoption by the Company of any amendment to the Plan or the termination thereof, will constitute and represent, without any further action on the part of any Participating Company, the approval, adoption, ratification or confirmation by each Participating Company of any such amendment or termination. In addition, the appointment of or removal by the Company of any member of the Benefit Appeals Committee, any Plan Administrator or other person under the Plan shall constitute and represent, without any further action on the part of any Participating Company, the appointment or removal by each Participating Company of such person.

ARTICLE XIII

MISCELLANEOUS PROVISIONS

13.1 Tax Withholding. The Company or any other Participating Company may withhold from a Participant's Compensation or any payment made by it under this Plan such amount or amounts as may be required for purposes of complying with the tax withholding or other provisions

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of the Code or the Social Security Act or any state or local income or employment tax act or for purposes of paying any estate, inheritance or other tax attributable to any amounts payable hereunder.

13.2 Incapacity. If the Plan Administrator determines that any Participant or beneficiary entitled to payments under this Plan is incompetent by reason of physical or mental incapacity disability and is consequently unable to give a valid receipt for payments made hereunder, or is a minor, the Plan Administrator may order the payments becoming due to such person to be made to another person for his benefit, without responsibility on the part of the Plan Administrator to follow the application of amounts so paid. Payments made pursuant to this Section 13.2 shall completely discharge the Plan Administrator, the Company and the other Participating Companies and the Benefit Appeals Committee with respect to such payments.

13.3 Administrative Forms. All applications, elections and designations in connection with this Plan made by a Participant or beneficiary shall become effective only when received by the Plan Administrator in a form acceptable to the Plan Administrator.

13.4 Independence of Plan. Except as otherwise expressly provided herein, this Plan shall be independent of, and in addition to, any other benefit agreement or plan of a Participating Company or any rights that may exist from time to time thereunder.

13.5 No Employment Rights Created. This Plan shall not be deemed to constitute a contract of employment between the Company or any other Participating Company and any Participant, nor confer upon any Participant the right to be retained in the service of the Company or any other Participating Company for any period of time, nor shall any provision hereof restrict the right of the Company or any other Participating Company to discharge or otherwise deal with any Participant.

13.6 Responsibility for Legal Effect. Neither the Company, nor any other Participating Company, nor the Plan Administrator or the Benefit Appeals Committee, nor any officer, member, delegate or agent of any of them, makes any representations or warranties, express or implied, or

assumes any responsibility concerning the legal, tax, or other implications or effects of this Plan. Without limiting the generality of the foregoing, no Participating Company shall have any liability for the tax liability which a Participant may incur resulting from participation in this Plan or the accrual or payment of benefits hereunder.

13.7 Successors. The terms and conditions of this Plan shall inure to the benefit of and bind the Company, the other Participating Companies, and their respective successors and assigns, and the Participants, their beneficiaries, and the personal representatives of the Participants and their beneficiaries.

13.8 Controlling Law. This Plan shall be construed in accordance with the laws of the State of Delaware to the extent not preempted by laws of the United States.

13.9 Headings and Titles. The Section headings and titles of Articles used in this Plan are for convenience of reference only and shall not be considered in construing this Plan.

13.10 General Rules of Construction. The masculine gender shall include the feminine and neuter, and vice versa, as the context shall require. The singular number shall include the plural, and vice versa, as the context shall require. The present tense of a verb shall include the past and future tenses, and vice versa, as the context may require.

13.11 Execution in Counterparts. This Plan may be executed in any number of counterparts each of which shall be deemed an original and said counterparts shall constitute but one and the same instrument and may be sufficiently evidenced by any one counterpart.

13.12 Severability. In the event that any provision or term of this Plan, or any agreement or instrument required by the Plan Administrator hereunder, is determined by a judicial, quasi-judicial or administrative body of competent jurisdiction to be void or not enforceable for any reason, all other provisions or terms of this Plan or such agreement or instrument shall remain in full force and effect and shall be enforceable as if such void or nonenforceable provision or term had never been a part of this Plan, or such agreement or instrument except as to the extent the Plan

Administrator determines such result would have been contrary to the intent of the Company in establishing and maintaining this Plan.

13.13 Indemnification. The Company and its Affiliates shall jointly and severally indemnify, defend, and hold harmless any officer, Employee or director of the Company or an Affiliate (hereinafter an "Indemnified Individual"), for all acts taken or omitted in carrying out the responsibilities of the Company, Participating Company, Affiliate, Plan Administrator, Board, Compensation Committee or Benefit Appeals Committee under the terms of this Plan or other responsibilities imposed upon such Indemnified Individual by ERISA. This indemnification for all such acts taken or omitted is intentionally broad, but shall not provide indemnification for any civil penalty that may be imposed on such Indemnified Individual under ERISA Section 502(i), nor shall it provide indemnification for any liability imposed upon such Indemnified Individual for his embezzlement or diversion of Plan funds for the benefit of such Indemnified Individual. The Company and all Affiliates shall jointly and severally indemnify any such Indemnified Individual for expenses of defending a claim brought by a Participant, beneficiary, service provider, government entity or other person, including all legal fees and other costs of such defense and shall advance funds as necessary for such defense on a timely basis. The Company and all Affiliates shall also reimburse promptly or advance funds to any such Indemnified Individual for any monetary payment or obligation to pay of such Indemnified Individual arising from a successful claim against such Indemnified Individual in any court or arbitration. In addition, if a claim is settled (whether or not in connection with a formal legal action or arbitration) with the concurrence of the Company, the Company and all Affiliates shall jointly and severally indemnify any such Indemnified Individual for any monetary liability under any such settlement, and the expenses thereof. Such indemnification will not be provided to any person who is not, at the time of the events for which indemnity is sought, a present or former officer, Employee or director of the Company or an Affiliate, nor shall it be provided for any claim by the Company or an Affiliate against any such Indemnified Individual.

IN WITNESS WHEREOF, SEALY CORPORATION, the Company, by its appropriate officers duly authorized, has caused this Amendment and Restatement to be executed as of the 18th day of December, 2008.

SEALY CORPORATION

("Company")

By /s/ Kenneth L Walker

And /s/ Lawrence J. Rogers

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SEALY EXECUTIVE
SEVERANCE BENEFIT PLAN

Original Effective Date: December 1, 1992

Restatement Generally Effective: December 1, 2008

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AMENDMENT AND RESTATEMENT
OF THE
SEALY EXECUTIVE SEVERANCE BENEFIT PLAN

This Amendment and Restatement of the Sealy Executive Severance Benefit Plan is hereby made by Sealy Corporation, a corporation organized and existing under and by virtue of the laws of the State of Delaware (the "Company").

WITNESSETH:

WHEREAS, the Company previously established a severance benefit plan for certain of its executive employees and for certain executive employees of certain of its Subsidiaries in order to provide for such executive employees an opportunity to receive certain cash and other benefits in the event of separation from service, under certain conditions specified therein;

WHEREAS, it is desirable to amend and restate the Plan in order to comply with the provisions of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), to the extent applicable, and to make other desirable changes to the Plan; and

WHEREAS, the Board of Directors of the Company has approved adoption of such an amendment and restatement of the Plan by the Company;

NOW, THEREFORE, generally effective as of December 1, 2008, the Company hereby adopts an Amendment and Restatement to the Plan as follows:

ARTICLE I

PRELIMINARY PROVISIONS

1.1 Name. The name of the Plan as established hereunder is SEALY EXECUTIVE SEVERANCE BENEFIT PLAN.

1.2 Effective Date. The provisions of the Plan were originally effective December 1, 1992.

1.3 Restatement Date. Except as otherwise stated herein, the provisions of the amended and restated Plan shall be December 1, 2008. Provisions required to be effective as of an earlier date shall be deemed effective as of such date.

1.4 Purpose. This Plan was established and is hereby amended and restated in order to provide severance benefits to certain executive Employees of the Company and its Subsidiaries, under certain conditions specified in the Plan.

1.5 Employee Welfare Benefit Plan. This Plan is an employee welfare benefit plan as defined in Section 3(1) of ERISA. This Plan shall be administered in accordance with applicable law and regulations. Without limiting the generality of the foregoing, this Plan shall be administered in such a manner, and benefits hereunder shall be so limited (notwithstanding any apparently contrary provision of this Plan, specifically including Article V hereof) that this Plan shall be an employee welfare benefit plan as defined in Section 3(1) of ERISA and not an employee pension benefit plan as defined in Section 3(2) of ERISA.

1.6 Not a Funded Plan. It is the intention and purpose of the Company and its Subsidiaries that this Plan shall be deemed to be “unfunded” for tax purposes as well as being such a plan as would properly be described as “unfunded” for purposes of Title I of ERISA. Notwithstanding any apparently contrary provision, this Plan shall be interpreted and administered in such a manner that it will be so deemed and would be so described.

1.7 Section 409A Compliance. It is the intention and purpose of the Company and its Subsidiaries that this Plan shall be deemed at all relevant times to be in compliance with Section

409A of the Code and lawful guidance thereunder to the extent applicable. Notwithstanding any apparently contrary provision, this Plan shall be interpreted and administered in such manner, so that it will be so deemed. For periods on an after the effective date of Section 409A but prior to the Restatement Date, the Plan was administered in good faith compliance with Section 409A of the Code to the extent applicable, but without a formal compliance amendment for that period, as permitted in applicable guidance.

ARTICLE II

DEFINITIONS

The use of neuter, masculine and feminine pronouns shall each be read to include the others and the use of the singular shall be read to include the plural and vice versa. Unless the context otherwise indicates, the following words, when initially capitalized, shall have the following meanings under this Plan:

2.1 Affiliate. The word "Affiliate" shall mean any corporation which would be defined as a member of a controlled group of corporations which includes the Company or any business organization which would be defined as a trade or business (whether or not incorporated) which is under "common control" with the Company within the meaning of Sections 414(b) and (c) of the Code but, in each case, only during the periods any such corporation or business organization would be so defined.

2.2 Annual Base Compensation. The words "Annual Base Compensation" shall mean a Participant's annualized rate of base compensation from the Company or a Participating Subsidiary in effect on the date of a Participant's Separation from Service. Base compensation shall not be deemed to be reduced by any salary reduction or deferral contributions (as described in Sections 401(k), 125 and similar provisions of the Code) made by the Participant to any employee benefit plan of the Company or any Participating Subsidiary. Base compensation does not include cash bonus payments, stock bonus payments, performance share payments, overtime pay, incentive pay, Company or Subsidiary contributions on behalf of a Participant to any retirement or welfare benefit plan, imputed income reported for tax purposes or any payments in the nature of expense reimbursements.

2.3 Breach of Noncompetition Requirement. The words “Breach of Noncompetition Requirement” shall mean the occurrence of an event in which a Participant, at any time prior to his payment in full hereunder:

- (a) either while he is employed by the Company or any Subsidiary or after his Separation from Service; and
- (b) without the prior written permission of the Company;

either directly or indirectly operates or performs any advisory or consulting services for, invests in (other than an investment in publicly traded stock of a corporation, provided that the ownership of such equity interest does not give the Participant the right to control or substantially influence the policy or operational decisions of such corporation), or otherwise becomes employed by or associated with, in any capacity, a Competitive Entity.

2.4 Cause. The word “Cause” shall mean for purposes of this Plan, either:

- (a) the Participant’s willful violation of any written policies of the Company which violations are materially detrimental to the Company;
- (b) the Participant’s conviction of (or written, voluntary and freely given confession to) a felony involving moral turpitude;
- (c) the Participant’s conviction of (or written, voluntary and freely given confession to) a felony in connection with his employment;
- (d) a Participant’s theft, fraud, embezzlement, material willful destruction of property (including any operating system of the Company or any Subsidiary or material disruption of the operations of the Company or any Subsidiary;
- (e) a Participant’s being under the influence of illegal drugs or habitually under the influence of alcohol while on the job or on Company or any Subsidiary property;
- (f) a Participant’s engaging in conduct, in or out of the workplace, which has a material adverse effect on the reputation or business prospects of the Company or one of its Subsidiaries;

- (g) a Participant's willfully engaging in conduct while an employee of the Company or any of its Subsidiaries which caused the Company or any of its Subsidiaries to be found, in a final judgment of a court of law, to have a material civil or criminal liability under any federal or state law;
- (h) a Participant's disclosure of trade secrets, customer lists or other confidential information if the Company or any Subsidiary has taken measures designed to prevent such disclosure; or
- (i) a Participant's Breach of the Noncompetition Requirement.

2.5 Change of Control. For purposes of this Plan, the words "Change of Control" shall mean a change of control of the Company of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, as in effect on the Restatement Date (the "Exchange Act"), whether or not the Company is then subject to such reporting requirements; provided, that, without limitation, a Change of Control shall be deemed to have occurred if:

- (a) any "person" (as defined in Sections 13(d) and 14(d) of the Exchange Act), other than KKR Millennium GP LLC and affiliates (collectively, "KKR"), becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing twenty percent (20%) or more of the combined voting power of the Company's then outstanding securities; provided that a Change of Control shall not be deemed to occur under this Subsection (a) by reason of (A) the acquisition of securities by the Company or an employee benefit plan (or any trust funding such a plan) maintained by the Company, or (B) while KKR continues to beneficially own more than fifty percent (50%) of the combined voting power of the Company's then outstanding securities;
- (b) during any period of one (1) year there shall cease to be a majority of the Board comprised of "Continuing Directors" as hereinafter defined; or
- (c) the stockholders of the Company (A) approve a merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the

surviving entity) more than eighty percent (80%) of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation, or (B) approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of more than fifty percent (50%) of the Company's assets.

For purposes of this Subsection 2.5(c), a sale of more than fifty percent (50%) of the Company's assets includes a sale of more than fifty percent (50%) of the aggregate value of the assets of the Company and its Subsidiaries or the sale of stock of one or more of the Company's Subsidiaries with an aggregate value in excess of fifty percent (50%) of the aggregate value of the Company and its Subsidiaries or any combination of methods by which more than fifty percent (50%) of the aggregate value of the Company and its Subsidiaries is sold.

- (d) For purposes of this Agreement, a "Change of Control" will be deemed to occur:
- (i) on the day on which a twenty percent (20%) or greater ownership interest described in Subsection 2.5(a) is acquired (or, if later, the day on which KKR ceases to beneficially own more than fifty percent (50%) of the combined voting power of the Company's then outstanding securities) provided that a subsequent increase in such ownership interest after it first equals or exceeds twenty percent (20%) shall not be deemed a separate Change of Control;
 - (ii) on the day on which "Continuing Directors," as hereinafter defined, cease to be a majority of the Board as described in Subsection 2.5(b);
 - (iii) on the day of a merger, consolidation or sale or disposition of assets as described in Subsection 2.5(c); or
 - (iv) on the day of the approval of a plan of complete liquidation as described in Subsection 2.5(c).
- (e) For purposes of this Section 2.5, the word "Company" means Sealy Corporation, and, any other corporation or business organization in an unbroken chain of corporations or business organization ending with Sealy Corporation that owns, directly or indirectly, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock of Sealy Corporation other than KKR.

- (f) For purposes of this Section 2.5, the words “Continuing Directors” mean individuals who at the beginning of any period (not including any period prior to the Restatement Date) of one (1) year constitute the Board and any new director(s) whose election by the Board or nomination for election by the Company’s stockholders was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved.

2.6 Code. The word “Code” shall mean the Internal Revenue Code of 1986, as such may be amended from time to time, and lawful guidance promulgated thereunder. Whenever a reference is made to a specific Code Section, such reference shall be deemed to include any successor Code Section having the same or a similar purpose.

2.7 Committee. The word “Committee” shall mean the Benefit Appeals Committee constituted under the provisions of Article VI of this Plan.

2.8 Company. The word “Company” shall mean Sealy Corporation, a Delaware corporation, and any successor corporation or business organization which shall assume the duties and obligations of Sealy Corporation by operation of law or otherwise under this Plan.

2.9 Compensation Committee. The words “Compensation Committee” shall mean the Compensation Committee of the Board or its successor as determined by the Board. If the Compensation Committee has no successor, the duties of the Compensation Committee shall become duties of the Board. The Compensation Committee shall have such duties with respect to the Plan as shall be determined by the Board.

2.10 Competitive Entity. The words “Competitive Entity” shall mean any of the following mattress manufacturing companies in the United States or their mattress manufacturing or mattress wholesaling affiliates: Simmons, Serta, Spring Air, Kingsdown, Select Comfort and Tempur-Pedic or any of their successors or any other mattress manufacturing company or its

mattress manufacturing or mattress wholesaling affiliate which represents 10% or more of the mattress market in the United States.

Notwithstanding anything in this Section to the contrary, a company, partnership, organization, proprietorship, or other entity which purchases the stock or assets of a business unit directly from the Company or any Subsidiary shall not be deemed a Competitive Entity solely with respect to the products developed, manufactured, prepared, sold, or distributed by and the individuals employed by such business unit as of the date of such stock or asset purchase.

2.11 Continuous Employment. The words “Continuous Employment” shall mean employment for any uninterrupted period during which a Participant is an Employee of the Company and/or any Subsidiary and shall include any authorized Leaves of Absence.

2.12 Covered Employee. The words “Covered Employee” shall mean an Employee of a Participating Subsidiary who:

- (a) is employed by the Company or any Participating Subsidiary in a supervisory, managerial, sales or administrative job classification, is paid on a salaried or commission basis and is normally scheduled for thirty-five (35) or more hours of work per week;
- (b) is employed in a position with a Salary Grade of 12 or higher;
- (c) is not a member of a collective bargaining unit;
- (d) is not excluded from coverage by this Plan pursuant to the terms of his employment agreement;
- (e) is not a nonresident alien Employee who receives no earned income (within the meaning of Code Section 911(d)(2)) from a Participant Company or any Affiliate that constitutes income from sources within the United States (within the meaning of Code Section 861(a)(3)), except to the extent expressly permitted by this Plan; and
- (f) is not employed in a capacity reasonably categorized by the Company, a Participating Company or an Affiliate as a Leased Person, regardless of whether his status under the Code subsequently may be determined by a court, the Internal Revenue Service or other government entity to be a Covered Employee, an Employee or otherwise.

An Employee shall become a Covered Employee as of the first day on which he satisfies all of the requirements of Subsections 2.12 (a) through (f) above. An Employee shall cease to be a Covered Employee as of the first day thereafter on which he ceases to satisfy any one of such requirements.

2.13 Dependent. The word “Dependent” means any person who properly can be claimed as a dependent on the Participant’s Federal income tax return or properly could be claimed as a dependent except for the amount of such dependent’s earnings.

2.14 Employee. The word “Employee” shall mean any common law employee or Leased Person of a Participating Subsidiary or an Affiliate. The word “Employee” shall not include any person who renders service to a Participating Subsidiary or an Affiliate solely as a director or independent contractor. In the event a person renders service to a Participating Subsidiary or an Affiliate as a common law employee and in another capacity as a director, an independent contractor or otherwise as a self-employed individual, he shall be considered to be an Employee hereunder only in his capacity as a common law employee.

In the event a person who was not classified by a Participating Subsidiary or an Affiliate as a common law employee is subsequently determined by a court, the Internal Revenue Service or other governmental entity to be a common law employee, such person shall only be considered to be an Employee hereunder prospectively from the date of such determination, or, if later, at the time that such person is initially treated as an Employee on the payroll records of the Participating Subsidiary or Affiliate.

2.15 Effective Date. The words “Effective Date” shall mean the original effective date of this Plan which is December 1, 1992.

2.16 ERISA. The acronym “ERISA” shall mean the Employee Retirement Income Security Act of 1974, as amended, and lawful guidance promulgated thereunder. Whenever a reference is made to a specific ERISA Section, such reference shall be deemed to include any successor ERISA Section having the same or a similar purpose.

2.17 Leased Person. The words “Leased Person” shall mean, on and after December 1, 1997, any individual who, pursuant to an agreement between any Participating Company or Affiliate and any leasing organization, has performed services for the Participating Company, for an Affiliate or for related persons, as determined in accordance with Code Section 414(n)(6), on a substantially full time basis for a period of at least one (1) year; provided, however, that such services are performed under the primary direction or control of the Participating Company or the Affiliate.

In the event a person who was not classified by a Participating Company or an Affiliate as a Leased Person is subsequently determined by a court, the Internal Revenue Service or other governmental entity to be a Leased Person, such person shall only be considered to be a Leased Person hereunder prospectively from the date of such determination, or, if later, at the time that such person is initially treated as a Leased Person by a Participating Company or an Affiliate.

2.18 Leave of Absence. The words “Leave of Absence” means:

- (a) that period of interruption of active employment of an Employee caused by entrance into the Armed Services of the United States under such circumstances that he becomes entitled to reemployment rights under the law, such period being deemed to terminate at the expiration of such reemployment rights;
- (b) that period of interruption of active employment of an Employee, without pay, granted by the Company or any Subsidiary at the Employee’s request with the understanding that he will return to active employment at the expiration of such period, provided, that such interruption of active employment (1) does not exceed six months, and (2) is granted on a nondiscriminatory basis for a specific reason; and

(c) a period of jury duty.

2.19 Participant. The word “Participant” means a Covered Employee who has satisfied, and continues to satisfy, the eligibility requirements under the provisions of Section 3.1. A Participant shall cease to be a Participant upon his Separation from Service, provided that the mere existence of such a Separation from Service shall not in any way limit a Participant’s right to benefits which he shall be entitled to receive hereunder as a result of such Separation from Service.

2.20 Participating Subsidiary. The words “Participating Subsidiary” means a Subsidiary whose Employees may become eligible to participate in this Plan if such Employees otherwise satisfy the requirements of Section 3.1 hereof. As of the Restatement Date, all Subsidiaries are Participating Subsidiaries other than any Subsidiary not organized under the laws of the United States of America or one of the States thereof.

2.21 Plan. The word “Plan” shall mean the Sealy Benefit Equalization Plan, as previously established and amended, as set forth herein, and as it later may be amended.

2.22 Plan Administrator. The words “Plan Administrator” means Sealy, Inc., an Ohio corporation, or such successor as may be appointed by the Board of Directors of Sealy Corporation pursuant to Article VII hereof.

2.23 Plan Year. The words “Plan Year” means the twelve (12) month commencing on December 1 and ending on the following November 30.

2.24 Salary Grade. The words “Salary Grade” means the classification grade for an Employee’s job position. For purposes of this Plan, Salary Grade shall be determined utilizing the compensation policy of the Company and its Subsidiaries as in effect on the Effective Date even if that compensation policy is no longer in effect at the time of the event resulting in the need to determine benefits. If the compensation policy changes and there is no classification grade for an

Employee's job position under the policy in effect on the Effective Date, the Plan Administrator shall, on the basis of the job position's characteristics, assign it a classification grade for purposes of this Plan.

2.25 Separation from Service. The words "Separation from Service" shall mean a "separation from service" as defined for purposes of Section 409A of the Code for purposes of determining when a distribution may be made under the terms of a non-qualified deferred compensation plan such as this Plan. In general, a Separation from Service for purposes of this Plan occurs when there is a good faith severance of the employment relationship between the Company and its Affiliates and an Employee due to the Employee's death, retirement or other "termination of employment" (as that term is defined for purposes of identifying a Separation from Service for purposes of Section 409A). Specifically, the following shall apply:

- (a) An Employee will not be deemed to have a Separation from Service while on military leave, sick leave, or other bona fide (i.e., where there is a reasonable expectation that the Employee will return) leave of absence if the period of such leave does not exceed six (6) months, or, if longer, so long as Employee retains a right to reemployment with the Company or an Affiliate by law or contract. If the leave exceeds six (6) months and the Employee does not retain such a reemployment right, the Separation from Service occurs on the first day following such six (6) months. However, where the leave is due to any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than six (6) months, where such impairment causes the employee to be unable to perform the duties of his or her position of employment or any substantially similar position of employment, twenty-nine (29) months will be substituted for six (6) months for purposes of this Subsection;
- (b) An Employee will not be considered to have a Separation from Service merely due to transfer between employee and independent contractor status (including status as a director of the Company);
- (c) Whether a "termination of employment," as defined for purposes of the definition of Separation from Service under Section 409A of the Code, has occurred is determined based on whether the facts and circumstances indicate that the applicable Participating Company or Affiliate and the

Employee reasonably anticipated that:

- (i) no further services would be performed after a certain date; or
- (ii) that the level of bona fide services the Employee would perform after such date (whether as an Employee or independent contractor, including as a director) would permanently decrease to less than fifty percent (50%) of the average level of bona fide services provided in the immediately preceding thirty-six (36) months.

2.26 Subsidiary. The word “Subsidiary” shall mean any corporation in which the Company owns, directly or indirectly, stock possessing at least eighty percent (80%) or more of the total combined voting power of all classes of stock entitled to vote or at least eighty percent (80%) of the total value of shares of all classes of stock of such corporation, as determined pursuant to Section 1563(a)(1) of the Code, but only during the period any such corporation would be so defined.

2.27 Voluntary Termination. The words “Voluntary Termination” shall mean a Separation from Service upon a Participant’s resignation or retirement from the employ of the Company and its Subsidiaries. Without limiting the generality of the foregoing, a Participant shall be deemed to have incurred a Voluntary Termination upon a failure to report to work for three (3) consecutive working days without reasonable excuse.

2.28 Weekly Base Compensation. The words “Weekly Base Compensation” means Annual Base Compensation divided by fifty-two.

2.29 Years of Service. The words “Years of Service” means the number of years and portions thereof of Continuous Employment represented by the period of time commencing on the Participant’s most recent date of hire with the Company or any Subsidiary and ending on the date of Separation from Service.

ARTICLE III

ELIGIBILITY AND PARTICIPATION

3.1 Eligibility. Each Employee who, on or after the Restatement Date:

- (a) is a Covered Employee; and
- (b) has completed six (6) months of Continuous Employment with the Company or any Subsidiary, shall be eligible to participate in the Plan.

3.2 Participation. Each Covered Employee who satisfies the requirements of Section 3.1 on or after the Restatement Date shall commence participation in the Plan as of the Restatement Date or, if later, as of the date upon which he first satisfies the aforementioned requirements. A Participant shall continue to participate in the Plan as long as he continues to satisfy each and every requirement of Section 3.1 and shall cease to be a Participant immediately upon his failure to satisfy any of such requirements. An Employee who was previously a Participant and ceased to be a Participant, but again satisfies the requirements of Section 3.1, shall immediately commence participation in the Plan, except as provided in Section 3.4.

3.3 Leave Of Absence. A Participant shall continue to be a Participant throughout a Leave of Absence approved by the Company or Subsidiary by which he is employed.

3.4 Rehired Participant. If a Participant's employment is terminated and he is subsequently reemployed by the Company or any Participating Subsidiary, then subject to any applicable restriction under Section 409A of the Code, he shall become a Participant upon the completion of six (6) months of Continuous Employment following such reemployment if he otherwise satisfies the requirements of Section 3.1; provided, however, that Years of Service under this Plan shall be counted only from his most recent date of hire.

ARTICLE IV

QUALIFICATION FOR BENEFITS

4.1 Entitlement to Benefits. A Participant shall be entitled to receive the benefits specified in Article V hereunder if, at any time on or after the Restatement Date, such Participant experiences a Separation from Service, other than a Voluntary Termination, from the Company or any Participating Subsidiary as a result of:

- (a) a permanent reduction in the workforce (the elimination of an employment position, or a reduction in the number of authorized positions at a plant or other facility) of the Company or any Participating Subsidiary;
- (b) the permanent closing of a plant or other facility of the Company or any Participating Subsidiary;
- (c) the Participant's inadequate job performance for the Company or a Participating Subsidiary;
- (d) a material reduction in the Annual Base Compensation of a Participant (for purposes of this Section 4.1(d), and subject to lawful guidance under Section 409A of the Code, a material reduction will be deemed to have occurred if a Participant's Annual Base Compensation is reduced by five percent (5%) or more in any 12-month period);
- (e) a reduction in the Salary Grade of a Participant which would have the effect of materially reducing such Participant's benefits hereunder (for purposes of this Section 4.1(e), and subject to lawful guidance under Section 409A of the Code, a material reduction in a Participant's benefits hereunder shall be deemed to have occurred if a Participant's number of weeks of benefits is reduced); or
- (f) an involuntary transfer of the Participant's employment location which reasonably would necessitate the Participant's relocation of his personal residence.

For the purposes of Section 4.1(d), (e) and (f), the Participant shall be deemed to have incurred a Separation from Service, other than a Voluntary Termination, only if he shall (x) notify the Company or Participating Subsidiary of his intent to terminate his employment within thirty (30) days of the existence of the condition and (y) allow the Company or Participating

Subsidiary thirty (30) days to cure the condition and (z) if no such cure is made, resign his position with the Company or Participating Subsidiary within the thirty (30) day period next following the end of the Company's or Participating Subsidiary's thirty (30) day cure period. Subject to the provisions of Section 409A of the Code, a condition will not be deemed to exist until the later of the actual existence of the condition or the Participant gaining actual knowledge of the existence.

Notwithstanding the foregoing, the Participant shall not be so entitled to benefits in the event that:

- (1) such Separation from Service is for Cause; or
- (2) a permanent reduction in the workforce or permanent closing of a plant or other facility is effected in connection with the sale of all or a portion of the Company's or Participating Subsidiary's business (or a corporate reorganization of the Company or Participating Subsidiary) if the Participant is within thirty (30) days thereafter employed, or offered employment (if the offered employment is at an annual rate of compensation not less than the Participant's Annual Base Compensation and if such offered employment does not reasonably necessitate the Participant's relocation of his personal residence), by a successor enterprise; or
- (3) the Participant terminates employment prior to the termination date established by the Company or Participating Subsidiary in connection with a reduction in force or plant closing.

4.2 Source of Payments. The benefits under this Plan shall be paid as needed directly from the general assets of the Company or any Subsidiary as the Company shall direct. This Plan is an unfunded employee welfare benefit plan, and nothing herein shall be interpreted to require prefunding by the Company or any Subsidiary of the cost of benefits.

ARTICLE V

BENEFITS AND PAYMENT OF BENEFITS

5.1 Benefits. A Participant who has become entitled to benefits as a result of an event specified in Section 4.1 shall receive the following benefits:

- (a) Cash Severance Pay. Such Participant shall receive cash severance pay in an amount determined by multiplying his Weekly Base Compensation by a factor, based upon his Salary Grade and Years of Service, as set forth herein and subject to the minimum and maximum benefit as follows:

<u>Salary Grade</u>	<u>Factor</u>	<u>Minimum</u>	<u>Maximum</u>
12-13	Years of Service times 3	13 weeks	26 weeks
14-17	Years of Service times 6.5 for the first 4 Years of Service, 4 times Years of Service thereafter	26 weeks	52 weeks
18-20	Years of Service times 8.75 for the first 4 Years of Service, 4 times Years of Service thereafter	35 weeks	70 weeks
21 or higher	Years of Service times 13 for the first 4 Years of Service, 4 times Years of Service thereafter	52 weeks	104 weeks

- (b) Health and Dental Benefit. Such Participant shall receive health and dental benefit coverage for himself and his Dependents, if any, for the period of six months immediately following his Separation from Service under the health benefit plan of the Company or Subsidiary then in effect for such Participant, such coverage to be provided on the same terms and conditions applicable to active employees (as the same may be amended from time to time and subject to any legal limitations, such as are contained in Section 125 of the Code) in effect for such Participant on the day before the event specified in Section 4.1; provided, however, that such coverage shall be counted toward the period of continuation of coverage under the group health plan continuation coverage provisions of ERISA

and the Code; provided further, that such coverage shall end immediately upon a Participant ceasing to be eligible for such continuation coverage.

- (c) Group Term Life Insurance Benefit. Such Participant and his Dependents, if any, shall receive, for the period of six months immediately following his Separation from Service under the group term life insurance plan of the Company or any Subsidiary then in effect for such Participant, group term life insurance and supplemental and Dependent group term life insurance upon the same terms, coverage amounts and conditions (subject to any legal limitations, such as are contained in Section 125 of the Code) in effect for such Participant on the day before the event specified in Section 4.1; provided, however, that such coverage shall end immediately upon a Participant becoming eligible for coverage under any employer group term life insurance plan as a result of any subsequent employment.

5.2 Welfare Plan; Limitations On Severance Benefit. The maximum amount of the cash severance pay specified in Section 5.1(a) to which a Participant may otherwise be entitled, and the maximum period over which such payment may be made, shall be limited to the maximum amount and period, respectively, permitted under Department of Labor Regulations Section 2510.3-2(b) so that this Plan will not be considered a "Pension Plan" under such regulations.

5.3 Segmentation of Severance Benefit. For purposes of compliance with Section 409A of the Code, payments and benefits under this Plan (but only to the extent taxable) shall be divided into four (4) segments as follows:

- (a) Cash Severance. Effective for Plan Years commencing December 1, 2008, when included with any other amounts payable upon an "involuntary separation of service" (as defined in Treas. Reg. 1.409A-1(n)) that would be aggregated with such payment under Treas. Reg. 1.409A-1(b)(9)(iii), the Cash Severance Segment shall not exceed two (2) times the lesser of:
 - (i) the sum of the Participant's annualized compensation based upon the Participant's annual rate of pay for services provided to the Company or any Subsidiary for the calendar year preceding the calendar year in which the Separation from Service occurred (adjusted for any increase during such year that was expected to continue indefinitely if the Participant had not had a Separation from Service); or
 - (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) of the Code for the year in which the Participant has a Separation from Service, and shall be paid in full not later than the last day of the second (2nd) year following the year in which the Participant had the Separation from Service;
- (b) Deferred Compensation. The amount of cash severance pay in excess of the amount described in Subsection (a) shall be considered the Deferred Compensation Segment;
- (c) Health Benefits. The medical and dental benefits provided under Subsection 5.1(b) shall be considered the Health Benefit Segment and, as such, shall not be considered nonqualified deferred compensation; and
- (d) Other Benefits. To the extent not otherwise excluded, group term life insurance provided pursuant to Subsection 5.1(c) (and medical and dental benefits if the status described in Subsection 5.3(c) is not available) shall be considered the Other Segment and shall be excluded from the definition of nonqualified deferred compensation as a reimbursement or in-kind benefit payable for a limited period of time or a limited payment pursuant to Treas. Reg. 1.409A-1(b)(9)(v)(A) or (D) respectively, but if not so deemed shall be administered to comply with the provisions of Treas. Reg. 1.409A-3(i)(iv) with benefits provided as if the Participant were an Employee.

5.4 Payment of Cash Severance Pay. Payment of the cash severance pay specified in Section 5.1(a), as reduced pursuant to Section 5.2, shall commence to be made within thirty (30) days following the determination by the Plan Administrator, in accordance with Section 6.1, that the Participant is entitled to benefits. Such payments shall be subject to the following rules:

- (a) Payments shall be made on a semi-monthly basis;
- (b) Payments shall continue, unless benefits are forfeited as provided elsewhere in this Plan, for a number of semi-monthly payments equal to the Participant's number of weeks of cash severance pay (as determined pursuant to Section 5.1(a) hereof) divided by two and fifteen-hundredths (2.15), with any fractional quotient rounded up to the next greater integer;
- (c) Each semi-monthly payment shall be equal, unless benefits are further reduced or forfeited as provided elsewhere in this Plan, to his total cash severance pay specified in Section 5.1(a), as reduced pursuant to

Section 5.2, divided by the number of payments determined pursuant to Section 5.3(b) above; and

(d) Payments shall be subject to all applicable tax withholding and authorized deductions.

For purposes of this Plan, and in accordance with Treasury Regulation Section 1.409A-2(b)(2)(iii), each semi-monthly payment is to be treated as one in a series of separate payments.

5.5 Mitigation of Cash Severance Payments. The following mitigation provisions shall apply to:

- (a) The Cash Severance Segment of the Participant's cash severance pay; and
- (b) The Deferred Compensation Segment of the Participant's cash severance pay to the extent such mitigation provisions are permitted under Section 409A of the Code to apply to such Deferred Compensation Segment.

If a Participant becomes employed by an employer other than the Company or any Affiliate, as an employee, consultant or other independent contractor, or otherwise, prior to the completion of the payments described above in this Section 5.4 then his periodic cash severance benefits hereunder shall be forfeited to the extent of his base compensation (calculated in a manner substantially similar to the method described herein for calculating Annual Base Compensation) for the corresponding period from his new employer. Such a Participant shall notify the Plan Administrator within thirty (30) days of any such employment, of his base compensation from such employment and of any changes thereto. Failure to notify the Plan Administrator within thirty (30) days of such employment, compensation or changes shall result in forfeiture of all benefits hereunder following the date of such employment or change of compensation, respectively, and the Plan Administrator may recover amounts paid following such date of employment or change of compensation plus the costs of such recovery.

If a Participant becomes employed by the Company or any Affiliate, as an Employee, consultant or other independent contractor, Leased Person or otherwise, prior to the completion of the payments described above in this Section 5.4, then his periodic cash severance benefits hereunder shall be forfeited upon the commencement of such employment. Such a

Participant shall have the same obligation to notify the Plan Administrator of such employment as a Participant hired by an unrelated employer as described above in this Section 5.4; and the Plan Administrator shall have the same remedies as described above for breach of such obligation. Such an individual may again become a Participant in this Plan following such employment upon satisfaction of the eligibility requirements contained in Article III hereof but the forfeiture of benefits shall be permanent.

5.6 Recipient Of Cash Severance Benefit Payments. Cash severance payments specified in Section 5.1(a) shall be made to the Participant or his duly designated representative or guardian. In the event a Participant dies before being paid his total cash severance benefit, the remaining benefit shall be paid to his estate in a single cash lump sum on a date selected by the Plan Administrator within the ninety (90) day period beginning on the date which is thirty (30) days following the date of the Participant's death.

5.7 Distributions Subject to 409A. If the payment of any distribution or provision of medical, dental or life insurance coverage within six (6) months following the date of the Participant's Separation from Service would cause all or any portion of such distribution or provision to be subject to inclusion in the Participant's gross income for federal income tax purposes under Section 409A(a)(1)(A) of the Code, then the payment of any such amount or such provision shall be delayed until the first business day after such six (6) month period (or, if earlier, the date which is thirty (30) days after the date of the Participant's death). Without limiting the generality of the foregoing, the six (6) month delay would apply to the Deferred Compensation Segment of benefits under the Plan as described in Section 5.3 hereof. Following such six (6) month delay, payment of delayed amounts shall be made in a single sum payment on the first business day following such six (6) month period and any remaining payments will be made as previously scheduled. If provision of medical, dental or life insurance coverage must be delayed, the Employee shall be required to pay all relevant costs and premiums and shall be reimbursed on the first business day after the six (6) month delay if permitted by law.

ARTICLE VI

ADMINISTRATION

6.1 Appointment of Plan Administrator. The Plan Administrator shall be appointed by the Board of Directors of the Company, and may be removed or may resign upon thirty (30) days' written notice, or such lesser period of notice as is mutually agreeable. In the absence of another designation, Sealy, Inc., an Ohio corporation, shall be the Plan Administrator.

6.2 Powers and Duties of the Plan Administrator. Except as expressly otherwise set forth herein, the Plan Administrator shall be a named fiduciary of the Plan and shall have the authority and responsibility granted or imposed on a "plan administrator" by ERISA. The Plan Administrator shall be the agent for service of legal process and presentation of claims for benefits hereunder. The Plan Administrator shall determine any and all questions of fact, resolve all questions of interpretation of this Plan or related documents which may arise under any of the provisions of this Plan or such documents as to which no other provision for determination is made hereunder, and exercise all other powers and discretions necessary to be exercised under the terms of this Plan which it is herein given or for which no contrary provision is made. Subject to the provisions of any claims procedure hereunder, the Plan Administrator's decision with respect to any matter shall be final and binding on all parties concerned, and neither the Plan Administrator nor any of its directors, officers, employees or delegates nor, where applicable, the directors, officers or employees of any delegate, shall be liable in that regard except for gross abuse of the discretion given it and them under the terms of this Plan. The Plan Administrator may, from time to time, by action of its appropriate officers, delegate to designated persons or entities the right to exercise any of its powers or the obligation to carry out any or all of its duties as Plan Administrator.

6.3 Engagement of Advisors. The Plan Administrator may employ actuaries, attorneys, accountants, brokers, employee benefit consultants, and other specialists to render advice

concerning any responsibility the Plan Administrator or Committee has under this Plan. Such persons may also be advisors to the Company or any Subsidiary.

6.4 Payment of Costs and Expenses. The costs and expenses incurred in the administration of the Plan shall be paid directly by the Company or one or more of the Subsidiaries, as directed by the Company. Such costs and expenses include those incident to the performance of the responsibilities of the Plan Administrator or Committee, including but not limited to, fees of accountants, legal counsel and other specialists, and other costs of administering this Plan. Notwithstanding the foregoing, in no event will any person serving in the capacity of Plan Administrator, or Committee member who is a full-time employee of the Company or an Affiliate be entitled to any compensation for such services.

6.5 Claims Procedure. The Plan Administrator shall establish and maintain a claims procedure under the Plan and shall establish and appoint the members of a Benefit Appeals Committee with appropriate powers in connection therewith.

6.6 Limitation of Liability. Except as otherwise provided in ERISA, the Plan Administrator and the Committee, and their respective officers, employees and members, and directors, officers and employees of the Company, the Participating Subsidiaries and Affiliates, shall incur no personal liability of any nature whatsoever in connection with any act done or omitted to be done in the administration of this Plan. No person shall be liable for the act of any other person.

ARTICLE VII

AMENDMENT AND TERMINATION

7.1 Amendment Power. The Company reserves the right (without the consent of any Participating Subsidiary, Participant or other person) to amend this Plan at any time, or from time to time, as evidenced by an instrument in writing executed in the name of the Company by one (1) or more of its officers who have the authority to do so. Any such amendment may be made retroactively effective and shall be binding upon the Participants, except that no such amendment shall retroactively deprive a Participant of a benefit hereunder.

7.2 Termination. The Company reserves the right (without the consent of any Participating Subsidiary, Participant or other person) to terminate this Plan at any time as evidenced by an instrument in writing executed in the name of the Company by three (3) or more of its officers who have the authority to do so provided such termination shall not be retroactive.

7.3 Result of Termination. If the employment of an Employee terminates, whether voluntarily or involuntarily, after the effective date of the Plan termination, he shall not be eligible to receive any severance benefits under this Plan.

7.4 Restrictions on Amendment and Termination. Notwithstanding any contrary provision of this Plan, no amendment or termination of this Plan shall be effective to:

- (a) restrict eligibility to participate in this Plan;
- (b) restrict eligibility for benefits under this Plan;
- (c) reduce benefit levels under this Plan; or
- (d) otherwise curtail benefits under this Plan,

without a written notice to substantially all of the affected Participants, who are employed by the Company or a Participating Subsidiary on the date of such notice, at least one year prior to the effective date of such amendment or termination, except for any amendment necessary to comply with ERISA or other applicable law.

7.5 No Liability for Plan Amendment or Termination. Neither the Company, nor any Participating Subsidiary, nor any officer, Employee or director thereof shall have any liability because this Plan is amended or terminated. Without limiting the generality of the foregoing, none of the foregoing shall have any liability due to the Company terminating this Plan notwithstanding the fact that a Participant may have expected to have benefited from the Plan in a future Separation from Service had this Plan remained in effect without change until such time.

ARTICLE VIII

PARTICIPATING SUBSIDIARIES

8.1 Initial Participating Subsidiaries. The initial Participating Subsidiaries were defined as of the Effective Date.

8.2 Designation of Participating Subsidiaries. A Subsidiary of the Company will become a Participating Subsidiary under this Plan as of the date it becomes a Subsidiary. Such a Subsidiary's status as a Participating Subsidiary may be reflected by an amendment to Section 9.1 hereof which specifies the name of the Subsidiary and its adoption date, but such an amendment shall not be required in order for the Subsidiary to be a Participating Company. Any such amendment need only be executed by the Subsidiary.

8.3 Adoption of Supplements. The Company may determine that special provisions shall be applicable to some or all of the Employees of a Participating Subsidiary, either in addition to or in lieu of the provisions of this Plan, or may determine that certain Employees otherwise eligible to participate in this Plan shall not be eligible to participate in this Plan. In such event, the Company shall adopt a Supplement with respect to the Participating Subsidiary which employs such individuals which Supplement shall specify the Employees of the Participating Subsidiary covered thereby and the special provisions applicable to such Employees. Any Supplement shall be deemed to be a part of this Plan solely with respect to the Employees specified therein.

8.4 Amendment of Supplements. The Company, from time to time, may amend, modify or terminate any Supplement; provided, however, that any such amendment or termination shall be subject to the Plan's general rules with respect to amendment or termination of the Plan.

8.5 Termination of Participation of Participating Company. The Company may terminate the status of a Subsidiary as a Participating Subsidiary or such status may be terminated by events, as when a Participating Subsidiary ceases to be a Subsidiary. Termination of Participating Subsidiary status by the Company shall be subject to the Plans general rules with respect to amendment or termination of the Plan.

8.6 Delegation of Authority. The Company is hereby fully empowered to act on behalf of itself and the other Participating Subsidiaries as it may deem appropriate in maintaining the Plan. Without limiting the generality of the foregoing, such actions include obtaining and retaining the status of the Plan as described in Article 1 of the Plan and appointing attorneys-in-fact in pursuit thereof. Furthermore, the adoption by the Company of any amendment to the Plan or the termination thereof, will constitute and represent, without any further action on the part of any Participating Subsidiary, the approval, adoption, ratification or confirmation by each Participating Subsidiary of any such amendment or termination. In addition, the appointment of or removal by the Company of any member of the Benefit Appeals Committee, any Plan Administrator or other person under the Plan shall constitute and represent, without any further action on the part of any Participating Subsidiary, the appointment or removal by each Participating Subsidiary of such person.

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ARTICLE IX

MISCELLANEOUS

9.1 Exclusive Benefit. This Plan has been adopted for the exclusive benefit of the eligible Participants. Nothing herein contained shall be construed as giving to any Employee or any other person any legal or equitable right against the Company or any Affiliate unless such right shall exist by reason of the express provisions of this Plan or any action taken pursuant thereto and in compliance therewith.

9.2 Right of Discharge Reserved. Neither the establishment of the Plan nor anything herein contained shall be construed to confer upon any persons the right to be continued in the employ of the Company or any Subsidiary or to be employed in any particular position therewith nor shall it in any way affect the right of the Company or any Subsidiary to control its Employees and to terminate the service of any Employee at any time, for any reason and with or without notice.

9.3 Right of Set Off. To the extent allowable under applicable law, in the event that any amount is distributable to a Participant under this Plan and the Participant owes any amount to the Company or any Subsidiary for any reason, including, but not limited to, possible embezzlement that can only be proven through accounting evidence, the Plan Administrator may, in its sole discretion, deduct from the amount distributable to the Participant an amount equal to the amount owed to the Company or any Subsidiary. As of the Restatement Date, such right of set off shall apply to the Cash Severance Segment as defined in Section 5.3 but shall apply to the Deferred Compensation Segment, as defined in that Section, only in an amount not to exceed Five Thousand Dollars (\$5,000.00).

9.4 No Liability. No liability shall be incurred by the Company or any Affiliate beyond the specific provisions of this Plan.

9.5 Satisfaction of Claims. Any payment to any participant, or to his legal representative in accordance with the provisions of this Plan shall to the extent thereof be in full

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satisfaction of all claims hereunder against the Plan Administrator and the Company or any Affiliate, and the Plan Administrator may require such participant or legal representative as a condition precedent to such payment, to execute a receipt and release therefor in such form as shall be determined by the Plan Administrator.

9.6 Construction. The Plan shall be construed in accordance with, and governed by, ERISA in a manner which will assure compliance of the Plan's operation therewith and, to the extent applicable, the laws of the State of Delaware without respect to conflict of law provisions thereof.

9.7 Impossibility. In the event that it becomes impossible for the Company, Subsidiary, Committee or Plan Administrator to perform any act under this Plan, that act shall be performed which, in the judgment of the Company, Subsidiary, Committee, or Plan Administrator, as the case may be, will most nearly carry out the intent and purpose of this Plan.

9.8 No Assignment. Except as set forth herein, no rights of any kind under this Plan shall, without the written consent of the Plan Administrator, be transferable, assignable or encumberable (including as collateral or a pledge on any loan) by a Participant or any other person.

9.9 Notice. In the event that the Plan Administrator or the Committee shall be required under the Plan to notify any Participant of any occurrence or action taken under the Plan, such notice requirement shall be satisfied by mailing to the Participant a written notice of such occurrence or action addressed to the Participant at the last address on file with the Company, or by delivering such written notice to the Participant at such address.

9.10 Multiple Fiduciary Capacities. A person may serve in more than one fiduciary capacity hereunder.

9.11 Tax Withholding. The Company or any other Participating Company may withhold from a Participant's Compensation or any payment made by it under this Plan such amount or amounts as may be required for purposes of complying with the tax withholding or other provisions

of the Code or the Social Security Act or any state or local income or employment tax act or for purposes of paying any estate, inheritance or other tax attributable to any amounts payable hereunder.

9.12 Incapacity. If the Plan Administrator determines that any Participant or beneficiary entitled to payments under this Plan is incompetent by reason of physical or mental incapacity disability and is consequently unable to give a valid receipt for payments made hereunder, or is a minor, the Plan Administrator may order the payments becoming due to such person to be made to another person for his benefit, without responsibility on the part of the Plan Administrator to follow the application of amounts so paid. Payments made pursuant to this Section shall completely discharge the Plan Administrator, the Company and the other Participating Companies and the Benefit Appeals Committee with respect to such payments.

9.13 Administrative Forms. All applications, elections and designations in connection with this Plan made by a Participant or beneficiary shall become effective only when received by the Plan Administrator in a form acceptable to the Plan Administrator.

9.14 Independence of Plan. Except as otherwise expressly provided herein, this Plan shall be independent of, and in addition to, any other benefit agreement or plan of a Participating Company or any rights that may exist from time to time thereunder.

9.15 Responsibility for Legal Effect. Neither the Company, nor any other Participating Company, nor the Plan Administrator or the Benefit Appeals Committee, nor any officer, member, delegate or agent of any of them, makes any representations or warranties, express or implied, or assumes any responsibility concerning the legal, tax, or other implications or effects of this Plan. Without limiting the generality of the foregoing, no Participating Company shall have any liability for the tax liability which a Participant may incur resulting from participation in this Plan or the accrual or payment of benefits hereunder.

9.16 Successors. The terms and conditions of this Plan shall inure to the benefit of and bind the Company, the other Participating Companies and Affiliates, their respective successors and

assigns, and the Participants, their beneficiaries, and the personal representatives of the Participants and their beneficiaries.

9.17 Execution in Counterparts. This Plan may be executed in any number of counterparts each of which shall be deemed an original and said counterparts shall constitute but one and the same instrument and may be sufficiently evidenced by any one counterpart.

9.18 Severability. In the event that any provision or term of this Plan, or any agreement or instrument required by the Plan Administrator hereunder, is determined by a judicial, quasi-judicial or administrative body of competent jurisdiction to be void or not enforceable for any reason, all other provisions or terms of this Plan or such agreement or instrument shall remain in full force and effect and shall be enforceable as if such void or nonenforceable provision or term had never been a part of this Plan, or such agreement or instrument except as to the extent the Plan Administrator determines such result would have been contrary to the intent of the Company in establishing and maintaining this Plan.

9.19 Indemnification. The Company and its Affiliates shall jointly and severally indemnify, defend, and hold harmless any officer, Employee or director of the Company or an Affiliate (hereinafter an "Indemnified Individual"), for all acts taken or omitted in carrying out the responsibilities of the Company, Affiliate, Plan Administrator, Benefit Appeals Committee or Compensation Committee under the terms of this Plan or other responsibilities imposed upon such Indemnified Individual by ERISA. This indemnification for all such acts taken or omitted is intentionally broad, but shall not provide indemnification for any civil penalty that may be imposed on such Indemnified Individual under ERISA Section 502(i), nor shall it provide indemnification for any liability imposed upon such Indemnified Individual for his embezzlement or diversion of Plan funds for the benefit of such Indemnified Individual. The Company and all Affiliates shall jointly and severally indemnify any such Indemnified Individual for expenses of defending a claim brought by a Participant, beneficiary, service provider, government entity or other person, including all legal fees and other costs of such

defense and shall advance funds as necessary for such defense on a timely basis. The Company and all Affiliates shall also reimburse promptly or advance funds to any such Indemnified Individual for any monetary payment or obligation to pay of such Indemnified Individual arising from a successful claim against such Indemnified Individual in any court or arbitration. In addition, if a claim is settled (whether or not in connection with a formal legal action or arbitration) with the concurrence of the Company, the Company and all Affiliates shall jointly and severally indemnify any such Indemnified Individual for any monetary liability under any such settlement, and the expenses thereof. Such indemnification will not be provided to any person who is not, at the time of the events for which indemnity is sought, a present or former officer, Employee or director of the Company or an Affiliate, nor shall it be provided for any claim by the Company or an Affiliate against any such Indemnified Individual.

9.20 Titles and Headings. The titles and headings are for reference only. In the event of a conflict between a title or heading and the content of a Section, the content of the Section shall control.

IN WITNESS WHEREOF, Sealy Corporation, by its duly authorized officers, has executed this instrument in several counterparts, as of the 18th day of December, 2008.

SEALY CORPORATION

By: /s/ Kenneth L. Walker

Its: Senior Vice President, General Counsel

And: /s/ Lawrence J. Rogers

Its: President & CEO

And: /s/ Michael Q. Murray

Its: Assistant Secretary

409A AMENDMENT TO EMPLOYMENT AGREEMENT

This 409A AMENDMENT TO EMPLOYMENT AGREEMENT (this “Amendment”) is made and entered into as of December 30, 2008, by and between Sealy Corporation, a Delaware Corporation (the “Company”) and the individual employee or former employee executing this Amendment as indicated on the last page hereof (the “Employee”).

WHEREAS, the Company and the Employee are Parties to an employment agreement (the employment agreement, with any previous amendments and any related separation agreement(s), collectively the “Agreement”); and

WHEREAS, Congress amended the Internal Revenue Code of 1986, as amended (the “Code”) to enact a new Section 409A of the Code (such Section, with the Regulations and other official guidance issued thereunder, collectively “Section 409A”); and

WHEREAS, Section 409A regulates “nonqualified deferred compensation” plans and arrangements as very broadly defined (payments and benefits which are so defined as nonqualified deferred compensation are referred to herein as “NQDC”); and

WHEREAS, Section 409A provides for a penalty on an employee covered by such NQDC for violation of Section 409A in the amount of a twenty percent (20%) additional tax on such NQDC, plus applicable interest; and

WHEREAS, the Company is proposing to amend the Employee’s Agreement to assist the Employee in avoiding such tax and interest and to make other desirable changes; and

WHEREAS, the Company and the Employee now wish to amend the Agreement to comply with the requirements of Section 409A; and

WHEREAS, the Agreement permits the Parties to amend the Agreement by a writing signed by each Party.

NOW, THEREFORE, in consideration of the foregoing, of the mutual promises contained herein and of other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree to amend the Agreement as set forth herein, effective January 1, 2009, except as otherwise provided herein.

1. **Terminology.** This Amendment shall amend the terminology of the Agreement as provided herein. Initially capitalized words and terms used in this Amendment and not otherwise defined in this Amendment shall have the meanings ascribed to them in the Agreement unless the context otherwise clearly indicates.

2. **Intent.** The intent of the Parties is that payments and benefits under the Agreement as amended by this Amendment (the “Amended Agreement”) comply with Section 409A and, accordingly, to the maximum extent permitted, the Amended Agreement shall be interpreted to be in compliance therewith. To the extent that any provision of the Agreement is

modified in order to comply with Section 409A, such modification shall be made in good faith and shall, to the maximum extent reasonably possible, maintain the original intent and economic benefit to the Employee and the Company of the applicable provision without violating the provisions of Section 409A. While the Company is providing this Amendment to assist the Employee in complying with Section 409A, in no event whatsoever shall the Company be liable for any additional tax, interest or penalty that may be imposed on the Employee by Section 409A or damages for failing to comply with Section 409A.

3. Separation from Service. The Agreement is hereby amended by providing that a termination of employment shall not be deemed to have occurred for purposes of any provision of the Amended Agreement providing for the payment of any amounts or benefits upon or following a termination of employment unless such termination is also a "Separation from Service" within the meaning of Section 409A as described in Section 15 of this Amendment, and, for purposes of any such provision of the Agreement, references to a "termination," "termination of employment" or like terms shall mean "Separation from Service." The intent of this change is to comply with the provisions of Section 409A which forbid the payment of NQDC except on certain payment events, one of which is a Separation from Service as defined, but subject to certain employer elections. In addition, certain favorable rules apply to payments and benefits conditioned on a Separation from Service. The Company's elections with respect to the definition of "Separation from Service" are reflected in Section 15 of this Amendment.

4. Good Reason. The Agreement is hereby amended by deleting the Section of the Agreement defining "Good Reason" (and containing certain procedural rules) in its entirety and the substitution in lieu thereof of the definition (and procedural rules) set forth in Section 15 of this Amendment. The intent of this change is to comply with the provisions of Section 409A which treat payment of what might otherwise be deemed NQDC as other than NQDC and thus not subject to certain restrictions (including the "Delay Period" as described below) if it is paid due to an involuntary Separation from Service and then treats Separation from Service for a "Good Reason" as an involuntary Separation from Service (subject to restrictions on the definition of "Good Reason").

5. Specified Employee. Notwithstanding any other payment schedule provided in the Amended Agreement to the contrary, if the Employee is deemed as of the date of Separation from Service to be a "Specified Employee" within the meaning of that term under Section 409A and the Company's specified employee policy, then each of the following shall apply:

(a) With regard to any payment that is considered NQDC payable on account of a Separation from Service, such payment shall be made on the date which is the earlier of (i) the first business day following the expiration of the six (6) month period measured from the date of such Separation from Service of the Employee, and (ii) the thirtieth (30th) day following the date of the Employee's death (the "Delay Period") to the extent required under Section 409A. Upon the expiration of the Delay Period, all payments delayed pursuant to this Section (whether they would have otherwise been payable in a single sum or in installments in the absence of such delay) shall be paid to the Employee (or his personal representative in the event of his death) in a lump sum, and all remaining payments due under the Agreement shall be paid or provided in accordance with the normal payment dates specified for them herein; and

(b) To the extent that benefits to be provided during the Delay Period are considered NQDC provided on account of a Separation from Service, and such benefits are not otherwise exempt from Section 409A, the Employee shall pay the cost of such benefits during the Delay Period, and the Company shall reimburse the Employee, to the extent that such costs would otherwise have been paid by the Company or to the extent that such benefits would otherwise have been provided by the Company at no cost to the Employee, the Company's share of the cost of such benefits upon expiration of the Delay Period, and any remaining benefits shall be reimbursed or provided by the Company in accordance with the procedures specified in the Amended Agreement.

6. Benefits and Reimbursements. To the extent that reimbursements of expenses or in-kind benefits to be provided following the Employee's Separation from Service are not excluded from the definition of NQDC pursuant to Section 409A (and particularly including Treas. Reg. 1.409A-1(b)(9)(v)) and from the application of Treas. Reg. 1.409A-3(i)(1), then such reimbursements of expenses and in-kind benefits shall be subject to the following rules: (i) all reimbursements of eligible expenses under the Amended Agreement shall be made on or before the last day of the Employee's taxable year following the taxable year in which such expenses were incurred by the Employee, (ii) no right to reimbursement or in-kind benefit shall be subject to liquidation or exchange for another benefit; (iii) the amount of expenses eligible for reimbursement, or in-kind benefits provided during an Employee's taxable year shall not in any way affect the expenses eligible for reimbursement, or in-kind benefits to be provided, in any other taxable year (other than Section 409A permitted limits on medical benefits); (iv) reimbursement of expenses and in-kind benefits will be provided for the time period specified in the Amended Agreement; and (v) subject to the foregoing provisions of this Section 6, reimbursement of expenses and in-kind benefits will be provided as for active employees.

7. Separate Payments. For purposes of Section 409A, the Employee's right to receive any installment severance payments due to a Separation from Service pursuant to the Amended Agreement shall be treated as a right to receive a series of separate and distinct payments. Whenever a payment under the Agreement specifies a payment period with reference to a number of days, the actual date of payment within the specified period shall be within the sole discretion of the Company.

8. Offsets. Notwithstanding any other provision of the Amended Agreement to the contrary, in no event shall any payment under the Amended Agreement that constitutes NQDC be subject to offset by any other amount unless otherwise permitted by Section 409A.

9. Payment Schedule. Unless the Amended Agreement provides a specified and objectively determinable payment schedule to the contrary, as in Section 14 of this Amendment (with respect to bonus and bonus related installments) to the extent that any payment of base salary or other compensation is to be paid for a specified continuing period of time beyond the date of the Employee's Separation from Service in accordance with the Company's payroll practices (or other similar term), the installment payments of such base salary or other compensation shall be made upon such schedule as in effect upon the date of termination, but no less frequently than monthly.

10. Executive Severance Benefit Plan. The Agreement gives the Employee an election between the cash severance payments under the Company's Executive Severance Benefit Plan and the cash severance provisions of the Agreement. Because choices between severance payment schedules violate Section 409A, notwithstanding any contrary provision of the Agreement or the Executive Severance Benefit Plan, the Employee shall not have the option of electing a cash payment under the Executive Severance Benefit Plan and will cease to participate in such plan effective December 31, 2008 if he has not already ceased participation prior to that date.

11. Alternate Satisfaction of Company's Obligations. The Agreement provides that the Company may in some cases (and must in others) provide an economically equivalent benefit if a promised one cannot be provided at all or on the promised basis. Because such a provision might require substitution of one payment or benefit for another on a basis prohibited by Section 409A, the Parties agree that if the Company cannot provide a promised benefit or an "Alternative Benefit" in compliance with Section 409A, the Parties are left to their legal remedies. It may be noted that 409A provides that certain legal settlements are permissible.

12. Acceleration for Taxes. While Section 409A generally prohibits the acceleration of NQDC payments, it permits acceleration in certain circumstances to pay taxes where taxes are levied before the NQDC payment otherwise would be made. The Company agrees that it will accelerate payments for taxes to the extent permitted by Section 409A where provision for such payment is not otherwise made.

13. Elimination of Benefit. If the Employee's Agreement provides for an immediate lump sum severance payment and one or more installment alternatives, the Parties agree that the installment alternatives are not available. While it is anticipated that any such lump sum payment would be a "short term deferral" for purposes of Section 409A (and not NQDC subject to the Delay Period), for the avoidance of doubt, such a lump sum amount shall be bifurcated into two payments as follows:

(a) one payment will be in the amount permitted as an involuntary (including for Good Reason) severance payment not considered NQDC (i.e. basically twice the lesser of (i) annual compensation or (ii) the amount which may be treated as compensation by tax qualified retirement plans, reduced by other amounts considered as such severance pay and not otherwise excluded from NQDC); and

(b) the other payment will be the excess of the total amount over the amount described in (a), if any such excess exists;

with both payments to be made at the same time unless the amount described in (b) is determined to be subject to the Delay Period and therefore payable in accordance with Section 5 of this Amendment.

14. Bonus Installment Payments. If the Employee's Agreement provides for one or more payments related to his bonus opportunity, other than a bonus incorporated into the lump sum severance payment referred to in Section 13 of this Amendment, this Section 14 shall apply to such payments as follows:

(a) Calculated Bonus. If the Agreement provides for a bonus calculated as provided under the Bonus Plan and payable due to his Separation from Service but to which the Employee otherwise would not be entitled for the fiscal year of his Separation from Service (for example, a pro rata bonus calculated based on the portion of such fiscal year during which he was employed), such amount shall be paid as an installment on the first February 25 following the close of the calendar year in which his Separation from Service occurs; and

(b) Target Bonus. If the Agreement provides for the payment of one or more bonus amounts calculated at target under the Bonus Plan, such amounts shall be paid in installments as follows:

- (i) an installment calculated with respect to the remaining portion of the fiscal year in which the Separation from Service occurs (for example, a pro rata target bonus calculated based on the portion of such fiscal year following such Separation from Service) shall be paid on February 25 of the following calendar year;
- (ii) an installment calculated with respect to any subsequent fiscal year shall be paid on February 25 of the calendar year next following the calendar year in which such fiscal year ends; but
- (iii) any installment described in Subsection 14(b)(i) or (ii) which would be paid later than the last installment of the Employee's salary continuation will be paid simultaneously with that last installment payment of salary continuation.

15. Certain Definitions and Rules. The following definitions and rules apply for purposes of the Amended Agreement:

(a) For purposes of the Amended Agreement, "Separation from Service" means a "separation from service" as defined for purposes of Section 409A for purposes of determining when a distribution may be made under the terms of a nonqualified deferred compensation plan or arrangement. In general, a Separation from Service for purposes of the Amended Agreement occurs when there is a good faith severance of the employment relationship between the Company and its Affiliates and the Employee due to the Employee's death, retirement or other "termination of employment" (as that term is defined for purposes of identifying a Separation from Service for purposes of Section 409A). Specifically, the following shall apply:

- (i) The Employee will not be deemed to have a Separation from Service while on military leave, sick leave, or other bona fide (i.e., where there is a reasonable expectation that the Employee will return) leave of absence if the period of such leave does not exceed six (6) months, or, if longer, so long as the Employee retains a right to reemployment with the Company or an Affiliate by law or contract. If the leave exceeds six (6) months and the Employee does not retain such a reemployment right, the Separation from

Service occurs on the first day following such six (6) months. However, where the leave is due to any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than six (6) months, where such impairment causes the employee to be unable to perform the duties of his or her position of employment or any substantially similar position of employment, twenty-nine (29) months will be substituted for six (6) months for purposes of this Subsection 15(a)(i);

- (ii) The Employee will not be considered to have a Separation from Service merely due to transfer between employee and independent contractor status (including status as a director of the Company);
- (iii) Whether a “termination of employment,” as defined for purposes of the definition of Separation from Service under Section 409A, has occurred is determined based on whether the facts and circumstances indicate that the Company or Affiliate and the Employee reasonably anticipated that:
 - (A) no further services would be performed after a certain date; or
 - (B) that the level of bona fide services the Employee would perform after such date (whether as an employee or independent contractor, including as a director) would permanently decrease to less than fifty percent (50%) of the average level of bona fide services provided in the immediately preceding thirty-six (36) months.

For purposes of determining whether a Separation from Service has occurred, the word “Affiliate” shall mean any corporation which would be defined as a member of a controlled group of corporations which includes the Company or any business organization which would be defined as a trade or business (whether or not incorporated) which is under “common control” with the Company within the meaning of Sections 414(b) and (c) of the Code but, in each case, only during the periods any such corporation or business organization would be so defined.

- (b) For purposes of the Amended Agreement, “Good Reason” means, and related procedural rules are:
 - (i) any material reduction in either the annual base salary of the Employee or the Target Annual Bonus Percentage or maximum annual bonus percentage applicable to the Employee under the Bonus Plan,
 - (ii) any material reduction in the position, authority or office of the Employee,

- (iii) any material reduction in the Employee's responsibilities or duties for the Company,
- (iv) any material adverse change or reduction in the aggregate "Minimum Benefits," as hereinafter defined, provided to the Employee as of the date of the Agreement (provided that any material reduction in such aggregate Minimum Benefits that is required by law or applies generally to all Employees of the Company shall not constitute "Good Reason" as defined hereunder),
- (v) any relocation of the Employee's principal place of work with the Company to a place which reasonably would necessitate the Employee's relocation of his principal residence,
- (vi) the material breach or material default by the Company of any of its agreements or obligations under any provision of the Agreement, or
- (vii) failure of the purchaser, in connection with a sale or transfer of all or substantially all of the assets of the Company, to assume the Agreement in accordance with the provisions of the Agreement.

As used in this Subsection 15(b), an "adverse change or material reduction" in the aggregate Minimum Benefits shall be deemed to result from any reduction or any series of reductions which, in the aggregate, exceeds five percent (5%) (or such other minimum required percentage reduction in excess of five percent (5%) which is deemed to be material under Section 409A of the value of such aggregate Minimum Benefits determined as of the date of the Agreement. As used in this Subsection 15(b), Minimum Benefits are life insurance, accidental death, long term disability, short term disability, medical, dental, and vision benefits and the Company's expense reimbursement policy.

The Employee, within ninety (90) days following the existence of a condition which constitutes a Good Reason, shall give written notice to the Company of such Good Reason describing such Good Reason in detail and giving the Company thirty (30) days to cure the condition. The Company may indicate in writing that it acknowledges that the condition constitutes a Good Reason and that it is waiving its right to cure the condition. Such a waiver closes the cure period upon receipt by the Employee. Unless otherwise required by Section 409A of the Code, a Good Reason condition will not be considered to come into existence until the later of the actual existence of the condition or the date the Employee knew or should have known of the existence of the condition. If the Company does not waive the right to cure the condition and does in fact cure the condition within thirty (30) days following receipt of such notice, then such condition shall no longer provide a basis for the Employee's

Separation from Service to be deemed for Good Reason. If the Company does not cure the condition causing such Good Reason within the cure period, the Employee must resign within thirty (30) days following the close of such cure period (as such close may be accelerated by the Company's waiver) in order for such resignation to be deemed to be for such Good Reason. If the Employee does not give the written notice of Good Reason described above to the Company within ninety (90) days following the existence of a condition which constitutes a Good Reason, then such Good Reason shall no longer provide a basis for the Employee's Separation from Service with the Company for Good Reason.

16. Continued Effect. Except as specifically modified herein, the Agreement shall remain in full force and effect in accordance with all of its terms and conditions.

[The remainder of this page is intentionally left blank.]

IN WITNESS WHEREOF, the parties hereto have executed this Amendment to the Agreement as of the date first written above.

SEALY CORPORATION

By: _____

Name: _____

Title: _____

EMPLOYEE

(Dollars in thousands)	Fiscal Year Ended				
	November 30, 2008	December 2, 2007	November 26, 2006	November 27, 2005	November 28, 2004
Pre-tax income from operations	\$ 19,064	\$ 114,431	\$ 111,830	\$ 123,052	\$ (49,637)
Fixed charges:					
Interest expense and amortization of debt discount and financing costs	60,464	63,976	71,961	79,565	72,731
Rental—33%(b)	6,658	6,244	6,047	5,022	5,076
Total fixed charges	67,122	70,220	78,008	84,587	77,807
Earnings before income taxes and fixed charges	86,186	184,651	189,838	207,639	28,170
Ratio of earnings to fixed charges(a)	1.3x	2.6x	2.4x	2.5x	—

(a) For the year ended November 28, 2004, earnings were insufficient to cover fixed charges by \$49.6 million.

(b) The percent of rent included in the calculation is a reasonable approximation of the interest factor in the Company's operating leases.

QuickLinks

[Exhibit 12.1](#)

SEALY CORPORATION
CORPORATE SUBSIDIARIES AS OF JANUARY 15, 2009

Sealy Mattress Corporation
Sealy Mattress Company
Sealy Mattress Company of Puerto Rico
Ohio-Sealy Mattress Manufacturing Co., Inc.
Ohio-Sealy Mattress Manufacturing Co.
Sealy Mattress Company of Kansas City, Inc.
Sealy Mattress Company of Memphis
Sealy Mattress Company of Illinois
Brandwein & Company
Sealy Mattress Company of Albany, Inc.
Sealy of Maryland and Virginia, Inc.
Sealy of Minnesota, Inc.
North American Bedding Company
Sealy, Inc.
Mattress Holdings International LLC
The Ohio Mattress Company Licensing and Components Group
Sealy Mattress Manufacturing Company, Inc.
Sealy Technology LLC
Sealy Kurlon Ltd.
Sealy Korea, Inc.
Sealy (Switzerland) GmbH
Sealy (Switzerland) GmbH Finance Branch
Mattress Holdings International B.V.
Sealy Canada, Ltd.
Gestion Centurion, Inc.
Sealy Argentina Srl
Sealy Asia (Singapore) Pte, Ltd.
Sealy Asia (Hong Kong) Limited
Sealy Asia
Sealy do Brasil Limitada
Sealy Mattress Company Mexico S. de R.L. de C.V.
Sealy Servicios de Mexico S.A. de C.V.
Sealy Colchones de Mexico S.A. de C.V.
Mattress Holding SAS
Sapsa Bedding SAS
Sapsa Latex SL
Sapsa Bedding SL
Sapsa Bedding Srl
Sapsa Bedding GmbH
Sapsa Bedding Sprl (Belgium)
Sapsa Bedding Sprl (Holland)
Sealy Real Estate, Inc.
Sealy Texas Management, Inc.
Sealy Mattress Company of S.W. Virginia
Western Mattress Company
Advanced Sleep Products
Sealy Components—Pads, Inc.
Sealy Mattress Company of Michigan, Inc.

QuickLinks

[Exhibit 21.1](#)

[SEALY CORPORATION CORPORATE SUBSIDIARIES AS OF JANUARY 15, 2009](#)

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-139794 on Form S-8 of our reports dated January 15, 2009, relating to the consolidated financial statements and financial statement schedule of Sealy Corporation and subsidiaries (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the adoption of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" and Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" and the number of weeks included in fiscal years 2008, 2007 and 2006) and the effectiveness of Sealy Corporation's internal control over financial reporting as of November 30, 2008, appearing in this Annual Report on Form 10-K of Sealy Corporation and subsidiaries for the fiscal year ended November 30, 2008.

/s/ DELOITTE & TOUCHE LLP
Charlotte, North Carolina
January 15, 2009

QuickLinks

[Exhibit 23.1](#)

[CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM](#)

Chief Executive Officer Certification of the Type Described in Rule 13a-14(a) and Rule 15d-14(a)
Chief Executive Officer Certification of the Annual Financial Statements

I, **Lawrence J. Rogers**, certify that:

1. I have reviewed this annual report on Form 10-K of Sealy Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting, to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 15, 2009

/s/ LAWRENCE J. ROGERS

Lawrence J. Rogers
President and Chief Executive Officer
(Principal Executive Officer)

QuickLinks

[Exhibit 31.1](#)

[Chief Executive Officer Certification of the Type Described in Rule 13a-14\(a\) and Rule 15d-14\(a\) Chief Executive Officer Certification of the Annual Financial Statements](#)

Chief Financial Officer Certification of the Type Described in Rule 13a-14(a) and Rule 15d-14(a)
Chief Financial Officer Certification of the Annual Financial Statements

I, **Jeffrey C. Ackerman**, certify that:

1. I have reviewed this annual report on Form 10-K of Sealy Corporation;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting, to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 15, 2009

/s/ JEFFREY C. ACKERMAN

Jeffrey C. Ackerman
Executive Vice President and Chief Financial Officer (Principal Accounting Officer)

QuickLinks

[Exhibit 31.2](#)

[Chief Financial Officer Certification of the Type Described in Rule 13a-14\(a\) and Rule 15d-14\(a\) Chief Financial Officer Certification of the Annual Financial Statements](#)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,**

In connection with the Annual Report of Sealy Corporation (the "Company") on Form 10-K for the period ending November 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Lawrence J. Rogers, Chief Executive Officer of the Company and Jeffrey C. Ackerman, Chief Financial Officer of the Company, each certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

January 15, 2009

/s/ LAWRENCE J. ROGERS

Lawrence J. Rogers
President and Chief Executive Officer (Principal Executive Officer)

/s/ JEFFREY C. ACKERMAN

Jeffrey C. Ackerman
Executive Vice President and Chief Financial Officer (Principal Accounting Officer)

QuickLinks

[Exhibit 32.1](#)

[CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350.](#)

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