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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

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

For the Fiscal Year Ended December 30, 2006

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

For the transition period from _____ to _____.

Commission File No. 0-25121

SELECT COMFORT CORPORATION

(Exact name of registrant as specified in its charter)

MINNESOTA	**41-1597886**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6105 Trenton Lane North Minneapolis, Minnesota	**55442**
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: **(763) 551-7000**

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

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 by Rule 405 of the Securities Act.
YES x NO o

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 o 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 o

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. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.
Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company. YES o NO x

The aggregate market value of the common equity held by non-affiliates of the Registrant as of June 30, 2006, was $1,206,168,000 (based on the last reported sale price of the Registrant's common stock on that date as reported by NASDAQ).

As of February 9, 2007, there were 49,971,760 shares of the Registrant's common stock outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

The following table provides references to the location of information, required by Form 10-K, that is included in (a) the Registrant's Annual Report to Shareholders for the year ended December 30, 2006 (the "Annual Report to Shareholders") or (b) the Proxy Statement for the Registrant's 2007 Annual Meeting

of Shareholders to be held on May 15, 2007 (the "Proxy Statement"), a definitive copy of which will be filed within 120 days of Registrant's 2006 fiscal year-end. All such information set forth under the heading "Reference" below is included herein or incorporated herein by reference.

	ITEM IN FORM 10-K	REFERENCE
PART I		
Item 1.	Business	Business, pages 2 – 11 of this document
Item 1A.	Risk Factors	Risk Factors, pages 12 – 22 of this document
Item 1B.	Unresolved Staff Comments	Unresolved Staff Comments, page 22 of this document
Item 2.	Properties	Properties, pages 23 – 24 of this document
Item 3.	Legal Proceedings	Legal Proceedings, page 24 of this document
Item 4.	Submission of Matters to a Vote of Security Holders	Submission of Matters to a Vote of Security Holders, page 24 of this document
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	Common Stock, Comparative Stock Performance and Equity Compensation Plan Information, pages 25 – 27 of this document
Item 6.	Selected Financial Data	Selected Consolidated Financial Data, page 28 of this document
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	Management's Discussion and Analysis of Financial Condition and Results of Operations, pages 29 – 37 of this document
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	Quantitative and Qualitative Disclosure about Market Risk, page 37 of this document
Item 8.	Financial Statements and Supplementary Data	Pages 38 – 60 of this document
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure, page 61 of this document
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PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	Election of Directors, Corporate Governance and Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement; Executive Officers of the Registrant, pages 10 – 11 of this document; Directors, Executive Officers and Corporate Governance, page 62 of this document
Item 11.	Executive Compensation	Executive Compensation in the Proxy Statement
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement
Item 13.	Certain Relationships and Related Transactions and Director Independence	Certain Relationships and Related Transactions in the Proxy Statement
Item 14.	Principal Accountant Fees and Services	Approval of Selection of Independent Registered Public Accounting Firm in the Proxy Statement
PART IV		
Item 15.	Exhibits, Financial Statement Schedules	Exhibits and Financial Statement Schedules, pages 63 – 64 of this document

As used in this Form 10-K, the terms "we," "us," "our," the "company" and "Select Comfort" mean Select Comfort Corporation and its subsidiaries and the term "common stock" means our common stock, par value $0.01 per share.

As used in this Form 10-K, the term "bedding" includes mattresses, box springs and foundations and does not include bedding accessories, such as sheets, pillows, headboards, frames, mattress pads and related products.

Select Comfort®, Sleep Number®, Comfort Club®, Sleep Better on Air®, The Sleep Number Bed by Select Comfort (logo)®, Select Comfort(logo with double arrow design)®, Firmness Control System™, Precision Comfort®, Corner Lock™, Intralux®, Everybody has a Sleep Number™, Knowing your Sleep Number is the Key to a Perfect Night's Sleep™, The Sleep Number Store by Select Comfort (logo)®, You can only find your Sleep Number on a Sleep Number Bed by Select Comfort™, Select Comfort Creator of the Sleep Number Bed®, What's Your Sleep Number? ®, Grand King®, Sleep Number SofaBed™, Personalized Warmth Collection®, GridZone®, and our stylized logos are trademarks and/or service marks of Select Comfort. This Form 10-K may also contain trademarks, trade names and service marks that are owned by other persons or entities.

Our fiscal year ends on the Saturday closest to December 31, and, unless the context otherwise requires, all references to years in this Form 10-K refer to our fiscal years. Our fiscal year is based on a 52- or 53-week year. All years presented in this Form 10-K are 52 weeks, except for the 2003 fiscal year ended January 3, 2004, which is a 53-week year.

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PART I

This Annual Report on Form 10-K contains or incorporates by reference certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For this purpose, any statements contained in or incorporated by reference into this Annual Report on Form 10-K that are not statements of historical fact may be deemed to be forward-looking statements, including but not limited to projections of revenues, results of operations, financial condition or other financial items; any statements of plans, strategies and objectives of management for future operations; any statements regarding proposed new products, services or developments; any statements regarding future economic conditions, prospects or performance; statements of belief and any statement

or assumptions underlying any of the foregoing. In addition, we or others on our behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or Web casts open to the public, in press releases or reports, on our Internet Web site or otherwise. We try to identify forward-looking statements in this report and elsewhere by using words such as "may," "will," "should," "could," "expect," "anticipate," "believe," "estimate," "plan," "project," "predict," "intend," "potential," "continue" or the negative of these or similar terms.

Our forward-looking statements speak only as of the date made and by their nature involve substantial risks and uncertainties. Our actual results may differ materially depending on a variety of factors, including the items discussed in greater detail below under the caption "Risk Factors." These risks and uncertainties are not exclusive and further information concerning the company and our business, including factors that potentially could materially affect our financial results or condition, may emerge from time to time, including factors that we may consider immaterial or do not anticipate at this time.

We wish to caution readers not to place undue reliance on any forward-looking statement and to recognize that forward-looking statements are predictions of future results, which may not occur as anticipated. We assume no obligation to update forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements. We advise you, however, to consult any further disclosures we make on related subjects in our quarterly reports on Form 10-Q and current reports on Form 8-K that we file with or furnish to the Securities and Exchange Commission.

ITEM 1. BUSINESS

Our Business

Overview

Select Comfort Corporation was founded as a Minnesota-based corporation in 1987 by an entrepreneur who developed and manufactured adjustable firmness mattresses after considering other alternatives such as innerspring and water. We have evolved from a specialty, niché direct marketer to a nationwide multi-channel business with fiscal 2006 net sales of $806 million.

Our principal business is to develop, manufacture, market and support premium quality, adjustable-firmness beds and other sleep-related accessory products. We have a mission-driven culture, with passionate employees and customers. Our mission is to improve people's lives through better sleep. Our goal is to open a consumer's mind to take control of their sleep naturally, with a bed that adjusts with comfort and support, rather than having the consumer adjust to the bed.

In 1998, Select Comfort became a publicly-traded company listed on The NASDAQ Stock Market LLC (NASDAQ Global Select Market) under the symbol "SCSS." When used herein, the terms "Select Comfort," "Company," "we," "us" and "our" refer to Select Comfort Corporation, including consolidated subsidiaries.

Competitive Strengths

Differentiated, Superior Product

Our proprietary Sleep Number® bed was designed through sleep research. Clinical research has shown that people who sleep on a Sleep Number bed fall asleep faster and experience deeper sleep with fewer disturbances than those sleeping on a traditional innerspring mattress. The proprietary air-chamber technology of our Sleep Number bed allows adjustable firmness of the mattress at the touch of a button, independently adjustable on either side to meet each partners' individual preference. Our bed's sleep surface provides better sleep quality and greater relief of back pain in comparison with traditional innerspring mattress products.

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Distinctive Brand

In 2001, we created the Sleep Number brand. This branding strategy allows our advertising and consumer communication to focus on our bed's distinguishing and proprietary feature, adjustable firmness and support for personalized comfort, as represented by the digital Sleep Number display on the bed's hand-held remote control, with a brand message hierarchy as follows:

- A Sleep Number represents an ideal level of mattress comfort, firmness and support;
- Everybody has a Sleep Number™;
- Knowing your Sleep Number is the Key to a Perfect Night's Sleep™; and
- You can only find your Sleep Number on a Sleep Number Bed by Select Comfort™.

Controlled Selling Environment

Over 90% of our sales are generated through our direct-to-consumer sales channels. Our nationwide chain of retail stores provides a unique mattress shopping experience and offer a relaxed environment designed to provide education on the importance of sleep and the products that best fit consumers' needs. Controlling the selling process enables us to ensure that the unique benefits of our products are effectively communicated to consumers. Our multiple touch-points of service, including sales, delivery and post-sale service, provide several opportunities to communicate with our customers, reinforcing the sale and enabling us to understand and respond quickly to consumer trends and preferences.

Integrated Business Process

We are a vertically-integrated business from production through sales, delivery and customer service, which allows us to control quality, cost, price and presentation. The modular design of our Sleep Number bed allows a just-in-time, build-to-order system that enables our retail stores to be positioned as showrooms, requiring minimal inventory in our stores and in our plants enabling us to maximize cash flow and operate with a minimal working capital business model.

Growth Strategy

In 2005, we ranked as the 6th largest mattress manufacturer according to the June 19, 2006 edition of *Furniture/Today*, with a 5% market share of industry revenue and 2% market share of industry units. We ranked as the leading U.S. bedding retailer, according to the *Top-25 Bedding Retailers* report in the August 14, 2006 edition of *Furniture/Today*. Our vision is to be the leading brand in the bedding industry.

Building Brand Awareness

Our most significant growth driver has been building brand awareness. With approximately 16% unaided brand awareness in the U.S., we have significant opportunity for domestic growth through increasing awareness of the Sleep Number and Select Comfort brands.

The Sleep Number brand has been integrated into all of our sales channels and throughout our internal and external communication programs. We utilize a media mix that includes television, radio and print advertising in support of our Sleep Number marketing campaign with increasing use of Internet advertising and paid search in our media mix.

We also sell to commercial markets which increases the awareness of our brand through media exposure, trial, sales and word-of-mouth. These commercial markets include the QVC television shopping channel, the luxury motor home market and Radisson Hotels and Resorts® in the U.S., Canada and the Caribbean.

Expanding Distribution

Over the long-term, we expect to operate between 600 and 650 company-owned stores in the U.S. with annual square footage growth increasing by 7% to 10% per year. We supplement our company-controlled distribution channels with sales through a limited number of leading home furnishings and specialty bedding retailers. Our retail partner program is expected to grow to over 1,000 U.S. partner doors over a multi-year period. At that level of distribution, we expect our retail partner program to represent as much as 15% of our net sales mix.

In 2005, we expanded our distribution network outside the U.S. with a retail partner relationship in Canada. In 2006, the Canadian retail partner relationship grew to 119 doors. We believe opportunities exist to expand our products and brands throughout the world and have built a team to begin pursuing international expansion.

Accelerating Innovation

Our goal is to continue to lead the industry in innovative sleep products. We have historically introduced new features and benefits to our Sleep Number beds every two to three years, through a pipeline of research and development ("R&D") activities. In 2006, we ramped-up our investment in R&D with the goal of accelerating new and innovative product introductions. We plan to increase our research and development investment again in 2007 by approximately 50%. The introduction of new products and features is expected to benefit our results of operations beginning in 2008.

Leveraging our Infrastructure

We believe we are well positioned to sustain long-term profitable growth. Our vertically-integrated business model provides multiple sources for efficiency and leverage. Sustaining such performance over a multi-year period is based on expected scale efficiencies (fixed cost utilization) and cost containment initiatives. We also have an ongoing focus on productivity gains through a variety of programs, including the implementation of a new enterprise resource planning system in the first half of 2008, expansion of our pilot hub and spoke network, automation of home delivery services, marketing and sales initiatives, and a Six Sigma initiative to improve product and service quality.

Our Products

Mattress Sets

We offer five different Sleep Number bed models through our company-owned channels, including the Sleep Number 3000, 4000, 5000, 7000 and 9000. Each bed model comes in standard mattress sizes, ranging from twin to king, as well as some specialty mattress sizes. Our bed models vary in features, functionality and price. As you move up the product line, the Sleep Number bed models offer enhanced features and benefits, including higher-quality fabrics and cover filling, additional cushion and padding, higher overall mattress profiles, quieter Firmness Control Systems with additional functions, and wireless remote controls as a standard feature.

The contouring support of our Sleep Number beds are optimized when used with our specially designed, proprietary foundation. This durable foundation, used in place of a box spring, is a modular design that can be disassembled and easily moved through staircases, hallways and other tight spaces.

Our mattress price points range from approximately $900 for the entry-level Sleep Number 3000 queen-size set (mattress and foundation) to $4,000 for the luxurious Sleep Number 9000 queen-size set. Our most popular model is the 5000 queen-size set and sells for approximately $1,900. These prices are subject to periodic promotional offerings.

Our unique product design allows us to ship our beds in a modular format to customers throughout the U.S. by United Parcel Service ("UPS"). For an additional fee, customers can take advantage of our home delivery service, which includes bed assembly and optional mattress removal services.

We also manufacture our Sleep Number beds for distribution through our retail partners. Our retail partner beds have different model numbers or names, but have similar features and benefits, and sell for similar prices.

Each of our Sleep Number beds come with a 30 night in-home trial and better night's sleep guarantee, which allows customers 30 nights at home to make sure they are 100% comfortable with the bed. The customer is responsible for the return shipping costs. Independent durability testing has shown our Sleep Number beds to withstand more than 20 years of simulated use, and each of our Sleep Number beds is backed by our 20-year limited warranty.

Accessories

In addition to our mattresses and foundations, we offer a line of accessory bedding products, including specialty pillows, mattress pads, comforters, sheets, bed foundations and leg options. The specialty pillows, available in a variety of sizes, materials and firmness levels, are designed to provide personalized comfort and better quality sleep for stomach, back or side sleepers. We also market our Personal Warmth Collection™, a group of comforters and blankets designed to be twice as warm on one half of the bed as the other, accommodating varying warmth preferences among couples.

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Other Products and Services

In 2003, we completed the roll-out of our Precision Comfort adjustable foundation to all of our company-owned retail stores. The adjustable foundation enables consumers to raise the head or foot of the bed, and to experience the comfort of massage, using a handheld remote control.

In 2004, we introduced the Sleep Number SofaBed line into a select number of our stores. The SofaBed is now available in 180 stores in 75 U.S. markets. The Sleep Number SofaBed features a queen-size Sleep Number mattress inside a beautifully appointed sofa surround, which is available in a variety of fabrics or leather options.

Sales Distribution

Unlike traditional bedding manufacturers, which primarily sell through third-party retailers, over 90% of our sales are through one of three company-controlled distribution channels – Retail, Direct Marketing and e-commerce. These channels enable us to control the selling process to ensure that the unique benefits of our products are effectively presented to consumers. Our direct-to-consumer business model enables us to understand and respond quickly to consumer trends and preferences.

Our retail stores accounted for 76% of our sales in 2006. Average net sales per company-owned store were $1,493,000 in 2006 versus $626,000 in 2001, with average sales per square foot of $1,244 in 2006 versus $666 in 2001. New stores are expected to average in excess of $900,000 in net sales in the first year of operations. In 2006, 81% of our stores generated net sales of over $1,000,000.

Our direct marketing call center and e-commerce Web site provide national sales coverage, including markets not yet served by one of our retail stores and accounted for 15% of our sales in 2006. In addition, these channels provide a cost-effective way to market our products, are a source of information on our products and refer customers to our stores if there is one near the customer.

Beginning in 2002, we supplemented our sales through semi-exclusive relationships with selected home furnishing retailers and specialty bedding retailers. Currently, this program includes 11 home furnishing retailers and specialty bedding retailers in the U.S. and Canada. In 2006, we aggressively expanded our retail partner program to 822 doors, up from 353 doors at the end of 2005. Each retail partner serves a unique geographic market, which enables us to increase sales and leverage our media spending to accelerate brand awareness.

Marketing and Advertising

Awareness among the broad consumer audience of our brand, product benefits and store locations has been our most significant opportunity for growth. The Sleep Number advertising campaign was introduced early in 2001 to support our retail stores in selected markets through our first comprehensive multi-media advertising campaign using prime-time TV, national cable television, infomercials, drive-time radio and newspaper advertisements. We have expanded the comprehensive local multi-media Sleep Number advertising campaign from the initial eight markets in 2001 to 37 markets in 2006. In addition, our successful radio personality endorsement advertising program now totals 145 radio personalities in approximately 126 retail store markets.

Since 2001, the Sleep Number brand positioning has been integrated into our marketing messages across all of our distribution channels, advertising vehicles and media types. We have increased our 1-800 advertising on national cable TV as an economical means of increasing brand awareness for our Sleep Number bed. Through our dedicated call center, we are able to provide the inquiring consumer more information or send a video and brochure. In 2006, our total media spending was approximately $105 million.

Owners of Sleep Number beds purchased through company-controlled channels are members of our Comfort Club, our customer loyalty program designed primarily to reward our owners for recommending our beds. Each time a referred customer purchases a bed, the referring Comfort Club member receives a $50 coupon for purchase of our products, with increasing benefits for multiple referrals. In 2006, approximately 45,000 new customers bought beds after receiving referrals from our Comfort Club members, and existing owners bought approximately 35,000 additional beds.

Qualified customers are offered revolving credit to finance purchases through a private-label consumer credit facility provided by GE Money Bank. Approximately 40% of our net sales during 2006 were financed by GE Money Bank or its predecessor, Mill Creek Bank. In 2005, we entered into an amended and restated agreement with GE Money Bank that

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extends this consumer credit arrangement through February 15, 2011, subject to earlier termination upon certain events and subject to automatic extensions. Under the terms of our agreement, GE Money Bank sets the minimum acceptable credit ratings, the interest rates, fees and all other terms and conditions of the customer accounts, including collection policies and procedures, and is the owner of the accounts. In connection with all purchases financed under these arrangements, GE Money Bank pays us an amount equal to the total amount of such purchases, net of promotional related discounts, upon delivery to the

customer. Consumers that do not qualify for credit under our agreement with GE Money Bank may apply for credit under a secondary program maintained by the company through another provider.

Operations

Manufacturing and Distribution

We have two manufacturing plants, one located in Irmo, South Carolina, and the other in Salt Lake City, Utah, which cost effectively distribute products in the U.S. and Canada. The manufacturing operations in South Carolina and Utah consist of quilting and sewing of the fabric covers for our beds and final assembly and packaging of mattresses and foundations. In addition, our electrical Firmness Control Systems are assembled in our Utah plant.

We manufacture beds on a just-in-time basis to fulfill orders rather than stocking inventory, which enables us to maintain lower levels of finished goods inventory and operate with limited regional warehousing. Orders are currently shipped from our manufacturing facilities via UPS or through our company-controlled home delivery, assembly and mattress removal service, typically within 48 hours following order receipt. Orders are usually received by the customer within five to 14 days from the date of order.

Suppliers

We obtain all of the raw materials and components used to produce our beds from outside sources. A number of components, including our proprietary air chambers, our proprietary blow-molded foundations, and various components for our Firmness Control Systems, as well as fabrics and zippers, are sourced from suppliers who serve as our sole source of supply for these components. Beginning in 2005, we initiated work on dual and alternate sourcing, successfully introducing a second source for printed circuit boards and certain foam and fiber components. We will continue working toward dual sourcing on targeted components.

Our proprietary air chambers are produced to our specifications by one Eastern European supplier, which has been our sole source of supply of air chambers since 1994. Our agreement with this supplier runs through September 2011 and is thereafter subject to automatic annual renewal unless either party gives 365 days' notice of its intention not to renew the agreement. We expect to continue this supplier relationship for the foreseeable future.

Our proprietary blow-molded foundations are produced to our specifications by one domestic supplier under an agreement that expires in December 2009. We expect to continue this supplier relationship for the foreseeable future.

All of the suppliers that produce unique or proprietary products for us have in place either contingency or disaster recovery plans or redundant production capabilities in other locations in order to safeguard against any unforeseen disasters. We review these plans and sites on a regular basis to ensure the supplier's ability to maintain uninterrupted supply of materials and components.

Home Delivery Service

Select Comfort's home delivery, assembly and mattress removal service has contributed to improving the overall customer experience. Our home delivery technicians are Sleep Number bed owners who can articulate the benefits of the bed, reinforcing the sales process and ensuring satisfied customers. Approximately 60% of beds sold through our company-owned retail stores in 2006 were delivered by our full-service home delivery team.

In 2003, we expanded the availability of our company-controlled delivery, assembly and removal services to all of our retail markets. In 2006, we made investments in home delivery systems and personnel to enable continued improvement and efficiency in our home delivery service. We plan to continue those investments and improvements in 2007 to help meet our expanded sales goals.

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Customer Service

We maintain an in-house customer service department staffed by customer service representatives who receive extensive training in sleep technology and all aspects of our products and operations. Our customer service representatives field customer calls and also interact with each of our retail stores to address customer questions and concerns. Our customer service team is part of our total quality process, facilitating early identification of emerging trends or issues. They coordinate with engineering and manufacturing to implement immediate solutions and provide inputs for long-term improvements to product design.

Research and Development

Our research and development team continuously seeks to improve product performance and benefits based on sleep science. Through customer surveys and consumer focus groups, we seek feedback on a regular basis to help enhance our products. Since the introduction of our first bed, we have continued to improve and expand our product line, including a quieter Firmness Control System, remote controls with digital settings, more luxurious fabrics and covers, new generations of foams and foundation systems, and enhanced border walls. Our research and development expenses were $4.7 million in 2006, $2.2 million in 2005, and $1.9 million in 2004.

Information Systems

We use information technology systems to analyze and manage our business, to reduce operating costs and to enhance our customers' experience. Our major systems include an in-store point of sale system, a retail portal system, in-bound and out-bound telecommunications systems for direct marketing and customer service, e-commerce systems, retail partner support systems, a data warehouse system and an enterprise resource planning system. These systems are comprised of both packaged applications licensed from market leaders and internally developed programs. Our production data center and e-commerce Web site are hosted at an outsourced facility that provides top-tier, fully-secured data center space. We maintain a disaster recovery plan that is tested annually.

We have recently undertaken plans to implement an integrated suite of SAP®-based applications, including enterprise resources planning, customer relationship management, supply chain management, product lifecycle management, supplier relationship management, human capital management, strategic enterprise

management, business intelligence and enterprise portal systems to replace many of our current systems. We believe this SAP-based IT architecture, along with best-practices-based processes and greater utilization of off-the-shelf, packaged solutions, will provide greater flexibility and functionality for our growing and evolving business model and be less expensive to maintain over the long-term. We currently expect the SAP implementation to be completed in the first half of fiscal year 2008.

Intellectual Property

We hold various U.S. and foreign patents and patent applications regarding certain elements of the design and function of our products, including air control systems, remote control systems, air chamber features, border wall and corner piece systems, foundation systems, and features related to sofa sleepers with air mattresses, as well as other technology. We have 24 issued U.S. patents, expiring at various dates between December 2007 and June 2022, and five U.S. patent applications pending. We also hold 19 foreign patents and 10 foreign patent applications pending. Notwithstanding these patents and patent applications, we cannot ensure that these patent rights will provide substantial protection or that others will not be able to develop products that are similar to or competitive with our products. To our knowledge, no third party has asserted a claim against us alleging that any element of our product infringes or otherwise violates any intellectual property rights of any third party.

"*Select Comfort*" and "*Sleep Number*" are trademarks registered with the U.S. Patent and Trademark Office. We have a number of other registered trademarks including our "*Select Comfort*" logo with the double arrow design, "*Select Comfort Creator of the Sleep Number Bed*," "*What's Your Sleep Number?*," "*Precision Comfort*," "*The Sleep Number Bed by Select Comfort*" (logo), "*The Sleep Number Store by Select Comfort*" (logo), "*Comfort Club*" and "*Sleep Better on Air*" and "*LuxLayer*." U.S. applications are pending for a number of other marks. Several of these trademarks have been registered, or are the subject of pending applications, in various foreign countries. Each federally registered mark is renewable indefinitely as long as the mark remains in use. We are not aware of any material claims of infringement or other challenges asserted against our right to use these marks.

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Industry and Competition

The U.S. bedding manufacturing industry is a mature and stable industry. According to the *2005 Annual Report* by the International Sleep Products Association (ISPA), industry wholesale shipments of mattresses and foundations were estimated to be $6.4 billion in 2005, compared to $5.8 billion in 2004. We estimate that traditional innerspring mattresses represent approximately 73% of total U.S. bedding sales.

The U.S. bedding retail industry is highly fragmented. According to the *Top-25 Bedding Retailers* report in the August 1, 2005 edition of *Furniture/Today*, the U.S. bedding retail industry was estimated to be $10.7 billion in 2004, with the top-25 retailers accounting for approximately 36% of total sales. We estimate that the U.S. bedding retail industry grew to nearly $12.0 billion in 2005 and more than $12.5 billion in 2006. *Furniture/Today* has ranked Select Comfort as the largest U.S. bedding retailer for six consecutive years.

Since 1984, the industry has consistently demonstrated growth on a dollar basis, with a 0.3% decline in 2001 being the only exception. Over the 5-year, 10-year and 20-year periods ended 2005, the value of U.S. wholesale bedding shipments increased at compound annual growth rates of 6.8%, 7.2% and 6.8%, respectively. We believe that industry unit growth has been primarily driven by population growth, and an increase in the number of homes (including secondary residences) and the increased size of homes. We believe growth in average wholesale prices resulted from a shift to both larger and higher quality beds, which are typically more expensive.

The bedding industry is highly competitive. Participants in the bedding industry compete primarily on price, quality, brand name recognition, product availability and product performance, including the perceived levels of comfort and support provided by a mattress. There is a high degree of concentration among the four largest manufacturers of innerspring bedding with nationally recognized brand names, including Sealy, which also owns the Stearns & Foster brand name, Serta, Simmons and Spring Air. Numerous other manufacturers, primarily operating on a regional or niche basis, serve the balance of the bedding market. Simmons and Sealy, as well as a number of smaller manufacturers, have offered air-bed products in recent years. Tempur-Pedic International, Inc., and a number of other mattress manufacturers, offer foam mattress products.

Governmental Regulation and Environmental Matters

Our operations are subject to federal and local consumer protection and other regulations relating to the bedding industry. These regulations vary among the jurisdictions in which we do business. The regulations generally impose requirements as to the proper labeling of bedding merchandise, restrictions regarding the identification of merchandise as "new" or otherwise, controls as to hygiene and other aspects of product handling and sale, and penalties for violations. Our direct marketing and e-commerce operations are or may become subject to various adopted or proposed federal and state "do not call" and "do not mail" list requirements.

The federal Consumer Product Safety Commission and various other regulatory agencies have been considering new rules relating to fire retardancy standards for the bedding industry. Effective December 31, 2005, the State of California adopted a new fire retardancy standard applicable to bedding products sold in California for general consumer residential use. In February 2006, the Consumer Product Safety Commission announced the adoption of a federal open flame fire retardancy standard similar to the California standard, which will be effective nationwide in July 2007. We are developing product modifications to meet the new standard, which will add costs to the modified products and require more complicated manufacturing processes, potentially reducing our manufacturing capacity.

A portion of our net sales consists of refurbished products that are assembled in part from components returned to us from customers. These refurbished products must be properly labeled and marketed as refurbished products under applicable laws. Our sales of refurbished products are limited to approximately 24 states, as the balance of the states does not allow the sale of refurbished bedding products.

We are subject to national and local laws and regulations relating to occupational health and safety, pollution and environmental protection. We will also be subject to similar laws in foreign jurisdictions as we further expand distribution of our products internationally.

Our retail pricing policies and practices are subject to antitrust regulations in the U.S., Canada and other jurisdictions where we may sell our products in the future.

We believe we are in compliance in all material respects with each of these governmental regulations.

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We are not aware of any national or local provisions which have been enacted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, that have materially affected, or will materially affect our net income or competitive position, or will result in material capital expenditures. During fiscal 2006, there were no material capital expenditures for environmental control facilities and no such material expenditures are anticipated.

Customers

No single customer accounts for 10% or more of our total sales. Therefore, the loss of any one customer would not have a material impact on our business.

Seasonality

Our business is subject to some seasonal influences, with typically lower sales in the second quarter and higher sales during the fourth quarter holiday season due to greater mall traffic.

Working Capital

Our investment to open a new store is approximately $250,000, including inventory. We target new stores to be cash flow positive within 12 months with a payback of the initial cash investment in less than 24 months. Our stores break even on a four-wall cash flow basis with approximately $600,000 of annual net sales. Our four-wall cash flow is calculated as gross profit generated from store sales less store expenses, without deduction of depreciation expenses.

The component nature of our products allows our stores to serve as product showrooms for our Sleep Number beds. This aspect of our business model allows us to maintain low inventory levels which enables us to operate with minimal working capital. We have historically generated sufficient cash flows to self-fund our growth through an accelerated cash-conversion cycle. In addition, our $100 million bank revolving line of credit is available for additional working capital needs or investment opportunities.

Employees

At December 30, 2006, we employed 3,053 persons, including 1,601 retail sales and support employees, 199 direct marketing and customer service employees, 954 manufacturing and logistics employees, and 299 management and administrative employees. Approximately 200 of our employees were employed on a part-time basis at December 30, 2006. Except for managerial employees and professional support staff, all of our employees are paid on an hourly basis plus commissions for sales associates. None of our employees is represented by a labor union or covered by a collective bargaining agreement. We believe that our relations with our employees are good.

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Executive Officers of the Registrant

William R. McLaughlin, 50, joined our company in March 2000 as President and Chief Executive Officer. In May 2004, Mr. McLaughlin was also elected to the position of Chairman of our Board of Directors. From December 1988 to March 2000, Mr. McLaughlin served as an executive of PepsiCo Foods International, Inc., a snack food company and subsidiary of PepsiCo, Inc., in various capacities, including from September 1996 to March 2000 as President of Frito-Lay Europe, Middle East and Africa, and from June 1993 to June 1996 as President of Grupo Gamesa, S.A. de C.V., a cookie and flour company based in Mexico.

J. Douglas Collier, 40, joined our company as Chief Marketing Officer and Senior Vice President, Marketing in July 2005. From 2002 to June 2005, Mr. Collier held leadership positions with La-Z-Boy Incorporated, most recently as Chief Marketing Officer and Vice President, Marketing and Furniture Galleries Development. From 2000 to 2001, Mr. Collier was the Senior Vice President, Marketing and Product Management for Iomega Corporation. From 1996 to 2000, he held various positions with NIBCO, Inc., including General Manager and Director of eBusiness and Marketing. From 1992 to 1996, Mr. Collier served in several capacities for Whirlpool Corporation, including as a Product Director for Whirlpool Europe and Director of Business Development and Process Improvement for Whirlpool North America. Prior to 1992, he held several positions with GE Canada (CAMCO).

Mark A. Kimball, 48, has served as Senior Vice President, Legal, General Counsel and Secretary since August 2003. From July 2000 to August 2003, Mr. Kimball served as Senior Vice President, Human Resources and Legal, General Counsel and Secretary. From May 1999 to July 2000, Mr. Kimball served as our Senior Vice President, Chief Administrative Officer, General Counsel and Secretary. For more than five years prior to joining us, Mr. Kimball was a partner in the law firm of Oppenheimer Wolff & Donnelly LLP practicing in the area of corporate finance.

Ernest Park, 54, joined our company as Senior Vice President and Chief Information Officer in May 2006. From November 2000 through March 2006, he served as Senior Vice President and Chief Information Officer at Maytag Corporation. Mr. Park previously managed the global information technology function as Vice President and Chief Information Officer of a shared services organization at AlliedSignal, and later with Honeywell International, following AlliedSignal's acquisition of Honeywell in 1999. He also served in various leadership capacities at Avnet Inc. from March 1980 through November 1996, culminating in his role as Corporate Vice President, Information Services Division.

Scott F. Peterson, 47, has served as Senior Vice President, Human Resources since August 2003. From January 2002 to August 2003, Mr. Peterson served as Senior Vice President, Human Resources, for LifeTime Fitness, a proprietor of health and fitness clubs. From March 2000 through November 2001, he served as

Chief People Officer for SimonDelivers.com, an internet-based grocery sales and delivery company. From 1990 through 2000, he served in a variety of capacities with The Pillsbury Company, a food manufacturer, most recently as Vice President, Human Resources, for the Bakeries and Foodservice Division.

James C. Raabe, 46, has served as Senior Vice President and Chief Financial Officer since April 1999. From September 1997 to April 1999, Mr. Raabe served as our Controller. From May 1992 to September 1997, he served as Vice President – Finance of ValueRx, Inc., a pharmacy benefit management provider. Mr. Raabe held various positions with KPMG LLP from August 1982 to May 1992.

Kathryn V. Roedel, 46, joined our company as Senior Vice President, Global Supply Chain in April 2005. From 1983 to 2005, she held leadership positions within two divisions of General Electric Company, in Sourcing, Manufacturing, Quality and Service. From 2003 to March 2005, Ms. Roedel served as the General Manager, Global Supply Chain Strategy for GE Medical Systems. Other key positions included General Manager, Global Quality and Six Sigma; Vice President – Technical Operations and Director/Vice President – Quality Programs for GE Clinical Services, a division of GE Medical Systems.

Wendy L. Schoppert, 40, joined our company as Senior Vice President and General Manager – New Channel Development & Strategy in April 2005 and effective January 2007, became our Senior Vice President – International. From 2002 to March 2005, Ms. Schoppert led various departments within U.S. Bancorp Asset Management, most recently serving as Head of Private Asset Management and Marketing. From 1996 to 2000, she held several positions with America West Holdings Corporation, including Vice President of America West Vacations and head of the airline's Reservations division. Prior to 1996, Ms. Schoppert held various finance-related positions at both Northwest Airlines and American Airlines.

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Keith C. Spurgeon, 52, joined our company as Senior Vice President, Sales in February 2002. From September 2000 to February 2002, Mr. Spurgeon served as an independent business consultant. From 1996 to September 2000 he was Chairman of the Board and Chief Executive Officer of Zany Brainy, Inc., a retailer of educational toys and books for children. Zany Brainy filed for Chapter 11 bankruptcy protection in May 2001. He served as Vice President-Asia/Australia at Toys "R" Us, Inc. from 1991 to 1996 after holding various management positions from 1986 to 1991. Mr. Spurgeon began his career at Jewel Food Stores.

Available Information

We are subject to the reporting requirements of the Exchange Act and its rules and regulations. The Exchange Act requires us to file reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"). Copies of our reports, proxy statements and other information can be read and copied at:

SEC Public Reference Room
100 F Street NE
Washington, D.C. 20549

Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains a Web site that contains reports, proxy statements and other information regarding issuers that file electronically with the SEC. These materials may be obtained electronically by accessing the SEC's home page at *http://www.sec.gov*.

Our corporate Internet Web site is *http://www.selectcomfort.com*. Through a link to a third-party content provider, our corporate Web site provides free access to our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after electronic filing with the SEC. These documents are posted on our Web site at *www.selectcomfort.com* — select the "*About Select Comfort*" link and then the "*Investor Relations*" link. The information contained on our Web site or connected to our Web site is not incorporated by reference into this Form 10-K and should not be considered part of this report.

We also make available, free of charge on our Web site, the charters of the Audit Committee, Management Development and Compensation Committee, Corporate Governance and Nominating Committee and Finance Committee as well as our Code of Business Conduct (including any amendment to, or waiver from, a provision of our Code of Business Conduct) adopted by our Board. These documents are posted on our Web site — select the "*Investor Relations*" link and then the "*Corporate Governance*" link.

Copies of any of the above referenced information will also be made available, free of charge, upon written request to:

Select Comfort Corporation
Investor Relations Department
6105 Trenton Lane North
Minneapolis, MN 55442

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ITEM 1A. RISK FACTORS

We may not be able to sustain growth or profitability.

Our net sales have grown in each of the last five fiscal years after two consecutive years of declining net sales. Our 22 most recent quarters have been profitable after eight consecutive quarters of losses. We may not be able to sustain growth or profitability on a quarterly or annual basis in future periods. Our future growth and profitability will depend upon a number of factors, including but not limited to:

- Our ability to manage growth in the size and complexity of our business, which has placed, and will continue to place, significant strains on our management, operations, information systems and other resources;
- The level of competition in the mattress industry and our ability to successfully identify and respond to emerging and competitive trends in the mattress industry;
- The level of consumer acceptance of our products, new product offerings and brand image;
- Our ability to continuously improve our products to offer new and enhanced consumer benefits, better quality and reduced costs;
- The effectiveness of our marketing messages and the efficiency of our advertising expenditures and other marketing programs in building product and brand awareness, driving traffic to our points of sale and increasing sales;
- Our ability to execute our retail store distribution strategy, including increasing sales and profitability through our existing stores, securing suitable and cost-effective locations for additional retail stores and cost-effectively closing under-performing store locations;
- Our ability to hire, train, motivate and retain qualified retail store management and sales professionals;
- Our ability to secure and retain wholesale accounts on a profitable basis and to profitably manage growth in wholesale distribution, including the impact on our retail stores and other company-controlled distribution channels;
- The success of our program with Radisson Hotels and Resorts in achieving planned levels of placement of our beds with the hotels and resorts and in driving consumer awareness of our product and brand;
- Our ability to cost-effectively expand our distribution internationally;
- Our ability to cost-effectively implement information systems changes, product design changes, manufacturing and procurement processes and document retention processes to comply with new federal flame retardancy standards applicable to mattresses and mattress and foundation sets effective as of July 1, 2007;
- Our ability to secure adequate sources of supply at reasonable cost, especially considering our single sources of supply for some components and just-in-time manufacturing processes, as well as potential shortages of commodities;
- Our ability to maintain sales volumes and profit margins and effectively manage the effects of inflationary pressures caused by rising fuel and commodity costs as well as fluctuating currency rates and increasing industry regulatory requirements, all of which could increase product and service costs;
- Our ability to cost-effectively offer consumer credit options through third party credit providers;
- The capability of our management information systems to continue to meet the requirements of our business and our ability to successfully implement our planned SAP-based enterprise-wide information technology architecture;
- General economic conditions and consumer confidence; and
- Global events, such as terrorist attacks or a pandemic outbreak, or the threat of such events.

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We may not be successful in executing our growth strategy or in sustaining profitable growth. Failure to successfully execute any material part of our strategic plan or growth strategy could significantly harm our business, operating results and financial condition.

The mattress industry is highly competitive. Our business could be significantly harmed by existing competitive pressures or from one or more new entrants into the market.

Our Sleep Number beds compete with a number of different types of mattress alternatives, including standard innerspring mattresses, foam mattresses, waterbeds, futons and other air-supported mattress products sold through a variety of channels, including home furnishings stores, specialty mattress stores, department stores, mass merchants, wholesale clubs, telemarketing programs, television infomercials and catalogs. The mattress industry is characterized by a high degree of concentration among the four largest manufacturers of innerspring mattresses with nationally recognized brand names, including Sealy, which also owns the Stearns & Foster brand, Serta, Simmons and Spring Air. Numerous other manufacturers, primarily operating on a regional or niche basis, serve the balance of the mattress market. Tempur-Pedic International, Inc. and other companies compete in the mattress industry with foam mattress products. A number of mattress manufacturers, including Sealy and Simmons, as well as a number of smaller manufacturers, including low-cost foreign manufacturers, have offered air beds that compete with our products.

We believe that many of our competitors, including in particular the four largest mattress manufacturers, have greater financial, marketing and manufacturing resources and better brand name recognition than we do and sell products through broader and more established distribution channels. Our stores and other company-owned distribution channels compete with other retailers who often provide a wider selection of mattress alternatives than we offer through our channels of distribution, which may place our channels of distribution at a competitive disadvantage. These manufacturing and retailing competitors, or new

entrants into the market, may compete aggressively and gain market share with existing and new mattress products, and may pursue or expand their presence in the air bed segment of the market. Some competitors may engage in aggressive advertising strategies that may include false or misleading claims about competitive products and/or our products. Any such competition could inhibit our ability to retain or increase market share, inhibit our ability to maintain or increase prices and reduce our margins, which could significantly harm our business.

Our products represent a significant departure from traditional innerspring mattresses and the failure of our products to achieve market acceptance would significantly harm our business, operating results and financial condition.

We estimate that innerspring mattress sales represent approximately 73% of all mattress sales. Our air chamber technology represents a significant departure from traditional innerspring mattresses. Because no established market for adjustable firmness mattress products existed prior to the introduction of our products in 1988, we faced the challenge of establishing the viability of this market, as well as gaining widespread acceptance of our products. The market for adjustable firmness mattresses is now evolving and our future success will depend upon both the continued growth of this market and increased consumer acceptance of our products. The failure of our products to achieve greater consumer acceptance for any reason would significantly harm our business, operating results and financial condition.

If we are unable to enhance our existing products and develop and market new products that respond to customer needs and achieve market acceptance, we may not be able to sustain our growth or profitability.

One of our growth strategies is to continue to lead our industry in product innovation and sleep expertise by enhancing existing products and by developing and marketing new products that deliver personalized comfort and better sleep. We may not be successful in developing or marketing enhanced or new products that will receive acceptance in the marketplace. Further, the resulting level of sales from any of our enhanced or new products may not justify the costs associated with the development and marketing. Any failure to continue to develop and market enhanced or new products in a cost-effective manner could harm our ability to sustain our growth or profitability.

Our future growth and profitability will depend in large part upon the effectiveness of our marketing messages and the efficiency of our advertising expenditures and other marketing programs in generating consumer awareness and sales of our products.

We are highly dependent on the effectiveness of our marketing messages and the efficiency of our advertising expenditures (which were approximately $105 million in 2006, $90 million in 2005, $79 million in 2004, $60 million in 2003, $40 million in 2002 and $30 million in 2001) in generating consumer awareness and sales of our products. If our marketing messages are ineffective or our advertising expenditures and other marketing programs are inefficient in creating greater awareness of our

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products and brand name, driving consumer traffic to our points of distribution and motivating consumers to purchase our products, our operating results and financial condition may be significantly and adversely impacted.

Our integrated marketing program depends in part on national radio personalities and spokespersons, including Paul Harvey, Rush Limbaugh and Lindsay Wagner and other nationally known personalities. The loss of these endorsements, or any reduction in the effectiveness of these endorsements, or our inability to obtain additional effective endorsements, could adversely affect our net sales and profitability.

Our future growth and profitability will depend in part upon the effectiveness and efficiency of our internet-based advertising programs and upon the prominence of our Web site URLs on internet search engine results.

We believe that consumers are increasingly using the internet as a part of their shopping experience, both to conduct pre-purchase research, particularly with respect to high end consumer durables, as well as to purchase products. Consumers will typically use one of a small number of internet search engines to research products. These search engines may provide both natural search results and purchased listings for particular key words. In some cases, it may be difficult or impossible to determine how these search engines work, particularly in the area of natural search, and therefore how to optimize placement on those search engines for our Web site URLs and other positive sites for consumers who may be searching for our products or for mattress products or retailers generally. Some of these search engines may permit competitors to bid on our trademarks to obtain high placement in search results when consumers use our trademarks to seek information regarding our products, which may cause confusion among consumers and adversely impact our sales. In addition, some of our competitors may use our trademarks and/or publish false or misleading information on the internet regarding our products or their own products, which may also cause confusion among consumers and adversely impact our sales.

As a result, our future growth and profitability will depend in part upon the effectiveness and efficiency of our on-line advertising and search optimization programs in generating consumer awareness and sales of our products, and upon our ability to prevent competitors from misusing or infringing our trademarks or publishing false or misleading information regarding our products or their own products. If we are not successful in these efforts, our business, reputation, operating results and financial condition may be significantly and adversely impacted.

In addition, if our Web site becomes unavailable for a significant period of time due to failure of our information technology systems or the Internet, our net sales could be materially and adversely affected.

Our comparable-store sales or other operating results may fluctuate significantly. An unanticipated decline in comparable-store sales or other operating results may disappoint investors and result in a decline in our stock price.

Our comparable-store sales and other operating results have fluctuated significantly in the past. For example, from 1998 through 2006, our quarterly comparable-store sales results ranged from a decrease of 9% to an increase of 38%. These past results may not be a meaningful indicator of future performance. Our comparable-store sales and other operating results may fluctuate or decline significantly in the future. Many factors affect our comparable-store sales and other operating results and may contribute to fluctuations or declines in these results in the future, including but not limited to:

- The effectiveness of our marketing messages and the efficiency of our advertising expenditures and other marketing programs in building awareness of

our products, brand and store locations, driving traffic to our store locations and increasing sales;

- Levels of consumer acceptance of our existing products, new product offerings and brand image;
- Consumer shopping trends, including traffic trends in shopping malls and lifestyle centers and internet shopping trends;
- Higher levels of sales in the first year of operations as each successive class of new stores is opened;
- Comparable-store sales performance in prior periods;
- The continuing maturation of our store base with increasing levels of average sales per store;
- Our ability to adequately hire, train, motivate and retain sales professionals and store-level managers;

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- The level of competitive activity;
- The growth of our other distribution channels, including in particular the wholesale distribution of our products through home furnishings and specialty mattress retailers into markets with existing company-owned retail stores;
- General economic conditions and consumer confidence; and
- Global events, such as terrorist attacks or a pandemic outbreak, or the threat of such events.

Future fluctuations or decreases in our comparable-store sales or other operating results could significantly harm our business, operating results and financial condition. In addition, an unanticipated decline in comparable-store sales or other operating results may disappoint securities analysts or investors and result in a decline in our stock price.

Our business is subject to seasonal influences and a substantial portion of our net sales is often realized in the last month or last few weeks of a quarter, due in part to our promotional schedule and commission structure. As our marketing expenditures are largely based on our expectations of future customer inquiries and net sales, and cannot be adjusted quickly, a failure to meet these expectations may harm our profitability.

Our business is subject to some seasonal influences, with typically lower sales in the second quarter and higher sales during the fourth quarter holiday season due to greater mall traffic. Furthermore, a substantial portion of our sales is often realized in the last month or last few weeks of a quarter, due in part to our promotional schedule and commission structure. The level of our sales and marketing expenses and new store opening costs is based, in significant part, on our expectations of future customer inquiries and net sales and cannot be adjusted quickly. If there is a shortfall in expected net sales or in the conversion rate of customer inquiries, we may be unable to adjust our spending in a timely manner and our profitability may be significantly harmed.

Significant and unexpected return rates under our 30-night trial period and warranty claims under our 20-year limited warranty on our beds, in excess of our returns and warranty reserves, could significantly harm our business, operating results and financial condition.

Part of our marketing and advertising strategy focuses on providing a 30-night trial in which customers may return their beds and obtain a refund of the purchase price if they are not fully satisfied with our product. As we expand our sales, return rates may not remain within acceptable levels. A significant and unexpected increase in return rates could significantly harm our business, operating results and financial condition. We also provide our customers with a 20-year limited warranty on our beds. However, since we have only been selling beds in significant quantities since 1992, we may receive significant and unexpected claims under these warranty obligations that could exceed our warranty reserves. Significant warranty claims in excess of our warranty reserves could significantly harm our business, operating results and financial condition.

Our plan to pursue additional and maintain existing wholesale relationships with home furnishings retailers, specialty mattress retailers and the QVC shopping channel may not yield the benefits we expect and may involve other risks that may harm our business.

An important element of our growth strategy is to expand profitable distribution by increasing sales through our existing channels and by increasing opportunities for consumers to become aware of, and to purchase, our products through additional points of distribution, such as home furnishings retailers and specialty mattress retailers. We have only recently established a limited number of wholesale relationships with home furnishings retailers, specialty mattress retailers and the QVC shopping channel and therefore have limited wholesale experience. Our wholesale relationships may not result in the intended benefits of leveraging our advertising spending and increasing our brand awareness, sales and overall market acceptance of our products. Our wholesale distribution may also adversely impact sales through our company-controlled distribution channels. We also expect the gross margin from wholesale sales to be less than the gross margin we generate in our company-controlled channels. The success of our wholesale strategy will depend upon numerous factors, including but not limited to the following:

- Our ability to analyze and identify suitable wholesale distribution partners and markets in which our retail presence is under-represented;
- Our ability to negotiate favorable distribution terms with our wholesale distribution partners;

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- Our ability and the ability of our wholesale distribution partners to adequately train, motivate and retain sales professionals who are selling our products;
- Our ability to adapt our distribution and other operational and management systems to an expanded network of points of sale;
- Our ability and the ability of our wholesale distribution partners to attract customers and generate sales sufficient to justify the expense of establishing the wholesale distribution relationship; and
- Our ability to maintain sales growth in our company-controlled retail stores in markets in which wholesale distribution partners are added.

We have established relationships with a limited number of home furnishings retailers and specialty mattress retailers over the last several years. The loss of one or more of these accounts could have a material adverse affect upon our wholesale distribution strategy and could adversely impact our ability to achieve our overall sales growth and profitability objectives. Any failure to achieve the objectives of our wholesale distribution strategy may significantly harm our operating results and financial condition.

Our program to place beds in Radisson Hotels and Resorts may fail to achieve planned objectives, which may harm our business and adversely impact our operating results and financial condition.

An important element of our growth strategy is to expand consumer awareness of our products and brand. In May 2004, we established a relationship with Radisson Hotels and Resorts with plans to replace a majority of the beds in Radisson Hotels and Resorts in the United States, Canada and the Caribbean with Sleep Number beds over several years. This program is designed in part to drive consumer awareness of our products and brand among the guests of Radisson Hotels and Resorts. The success of this strategy will depend upon numerous factors, including but not limited to levels of acceptance of our products among Radisson Hotels and Resorts franchisees, the execution of marketing programs in connection with this relationship, and the quality of guests' experiences on our beds at the Radisson Hotels and Resorts. Any material failure to achieve the objectives of this program with Radisson Hotels and Resorts may significantly harm our operating results and financial condition.

We have plans to expand our distribution internationally, which presents some additional risks to our business.

To date, the vast majority of our sales have been made in the U.S. and we have sold only very minimal quantities of products in foreign jurisdictions. In late 2005, we began to distribute our products in Canada through a Canadian-based bedding retailer and we have begun to pursue plans to enable distribution of our products in some other foreign countries. Expansion of our distribution to foreign jurisdictions, and our lack of experience in international distribution, present some risks to our business, including without limitation the need to build awareness of our products and brand in new markets, the need to gain market acceptance for new products that represent a significant departure from traditional bedding products, logistical and systems complexities, different levels of protection of our intellectual property, language and cultural differences, the need to comply with additional and different regulatory requirements, foreign currency exchange risks and political instability.

Although several members of our senior management team have significant experience in international distribution of consumer goods, as a company our experience in this area is limited. We plan to invest in our international infrastructure in advance of sales in international jurisdictions which may adversely impact our overall profitability. If we are unable to achieve consumer awareness and market acceptance for our products in foreign jurisdictions, we may not be able to achieve sufficient sales and profitability in our international operations to justify the investment.

We utilize "just-in-time" manufacturing processes with minimal levels of raw materials, work in process and finished goods inventories, which could leave us vulnerable to shortages of supply of key components. Any such shortage could result in our inability to satisfy consumer demand for our products in a timely manner and lost sales, which could significantly harm our business, operating results and financial condition.

We generally assemble our products after we receive orders from customers utilizing "just-in-time" manufacturing processes. Lead times for ordered components may vary significantly and depend upon a variety of factors, such as the location of the supplier, the complexity in manufacturing the component and general demand for the component. Some of our components, including our air chambers, have relatively longer lead times. We generally maintain minimal levels of raw materials, work in process and finished goods inventories, except for our air chambers, of which we generally carry approximately six weeks of inventory. As a result, an unexpected shortage of supply of key components used to manufacture our products, or an

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unexpected and significant increase in the demand for our products, could lead to inadequate inventory and delays in shipping our beds to customers. Any such delays could result in lost sales, which could significantly harm our business, operating results and financial condition.

Damage to either of our manufacturing facilities could increase our costs of doing business or lead to delays in shipping our beds, which could result in increased returns and adversely affect future sales.

We have two manufacturing plants, which are located in Irmo, South Carolina and in Salt Lake City, Utah. Unlike other mattress manufacturers, we manufacture beds to fulfill orders rather than stocking finished goods inventory. Therefore, the destruction or shutting down of either of our manufacturing facilities for a significant period of time as a result of fire, explosion, act of war or terrorism, flood, hurricane, tornado, earthquake, lightning or other natural disaster could increase our costs of doing business and lead to delays in shipping our beds to customers. Such delays could result in increased returns and adversely affect future sales. Due to our make-to-order business model, these adverse consequences to our business may be greater for our company than with other mattress manufacturers.

We rely upon several key suppliers that are, in some instances, our sole source of supply. The failure of one or more of these suppliers or our other key suppliers to supply components for our products on a timely basis, or a material change in the purchase terms for our components, could significantly harm our business, operating results and financial condition.

We currently obtain all of the materials and components used to produce our beds from outside sources. A number of components, including our proprietary air chambers, our proprietary blow-molded foundations, various components for our Firmness Control Systems, as well as fabrics and zippers, are sourced from

suppliers who serve as our sole source of supply for these components. We also obtain the wood foundations to support our wholesale and hospitality channels businesses and our adjustable foundations from sole sources of supply.

We have a supply agreement with the supplier of our air chambers that expires in September 2011, subject to automatic annual renewal thereafter unless either party gives 365 days' notice of non-renewal. We have a supply agreement with the supplier of our blow-molded foundations that expires in December 2009. We have a supply agreement with the supplier of our foam that expires in June 2008 with an option to renew the agreement for one year thereafter. If our relationship with either the supplier of our air chambers or the supplier of our blow-molded foundations is terminated, we could have difficulty in replacing these sources since there are relatively few other suppliers capable of manufacturing these components.

We generally purchase many of our other components and raw materials centrally to obtain volume discounts and achieve economies of scale. We therefore obtain a large percentage of our components and raw materials from a small number of suppliers. We purchase most of our components and raw materials through purchase orders and do not have any long-term purchase agreements with, or other contractual assurances of continued supply, pricing or access from, any of our suppliers, except for air chambers, blow-molded foundations, foam, fiber and circuit boards.

If prices for our key components increase and we are unable to achieve offsetting savings through value engineering or increased productivity or we are unable to increase prices to our customers, our operating results and financial condition may be significantly harmed. The loss of one or more of our key suppliers, the failure of one or more of our key suppliers to supply components to our products on a timely basis, or a material change in the purchase terms for our components could significantly harm our business, operating results and financial condition.

The foreign manufacturing of our air chambers and some of our other components involves risks that could increase our costs, lead to inadequate inventory levels or delays in shipping beds to our customers, which could substantially harm our business, operating results and financial condition.

Since our air chambers and some of our other components are manufactured outside the United States, our operations could be significantly harmed by the risks associated with foreign sourcing of materials, including but not limited to:

- Political instability resulting in disruption of trade;
- Existing or potential duties, tariffs or quotas that may limit the quantity of certain types of goods that may be imported into the United States or increase the cost of such goods;

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- Disruptions in transportation that could be caused by a variety of factors including acts of terrorism, shipping delays, foreign or domestic dock strikes, customs inspections or other factors;
- Any significant fluctuation in the value of the U.S. dollar against foreign currencies; and
- Economic uncertainties, including inflation.

These factors could increase our costs of doing business with foreign suppliers, lead to inadequate inventory levels or delays in shipping beds to our customers, which could substantially harm our business, operating results and financial condition. If any of these or other factors were to render the conduct of any of our foreign suppliers' businesses more difficult or impractical, we may have difficulty sourcing key components of our products, which could materially and adversely affect our operating results and financial condition.

Increases in commodity prices, component costs and/or delivery costs could harm our profitability.

Recently there have been significant increases or volatility in the prices of certain commodities, including but not limited to fuel, oil, natural gas, rubber, cotton, plastic resin, steel and chemical ingredients used to produce foam. Increases in prices of these commodities may result in significant cost increases for our raw materials and product components, as well as increases in the cost of delivering our products to our customers. These increases in costs may require us to increase our prices, potentially adversely impacting our unit sales volumes, and may increase our costs of doing business, potentially adversely impacting our operating results and financial condition.

We depend upon UPS and other carriers to deliver some of our products to customers on a timely and cost-effective basis. Any significant delay in deliveries to our customers could lead to increased returns and cause us to lose future sales. Any increase in freight charges could increase our costs of doing business and harm our profitability.

Historically, we have relied to a significant extent on UPS for delivery of our products to customers. For a significant portion of the third quarter of 1997, UPS was unable to deliver our products within acceptable time periods due to a labor strike, causing delays in deliveries to customers and requiring us to use alternative carriers. UPS may not be able to avert labor difficulties in the future or may otherwise experience difficulties in meeting our requirements in the future. From 2000 to 2003, we demonstrated an ability to shift a portion of our product delivery business to FedEx, as necessary. In addition, we either provide directly, or contract with a third party to provide, in-home delivery, assembly and mattress removal services, and in 2003 expanded the availability of this service to all of our retail stores across the country. Despite these alternative carriers, if UPS were to experience difficulties in meeting our requirements we may not be able to deliver products to all of our customers on a timely or cost-effective basis through any one or more of these or other alternative carriers. Any significant delay in deliveries to our customers could lead to increased returns and cause us to lose future sales. Any increase in freight charges could increase our costs of doing business and harm our profitability.

More than one-third of our net sales are financed by a third party. The termination of our agreement with this third party, any material change to the terms of our agreement with this third party or in the availability or terms of credit offered to our customers by this third party, or any delay in securing replacement credit sources, could harm our business, operating results and financial condition.

Our qualified customers are offered a revolving credit arrangement to finance purchases from us through a private label consumer credit facility provided by GE Money Bank. In December 2005 we entered into an amended and restated agreement with GE Money Bank that extends this consumer credit arrangement through February 15, 2011, subject to earlier termination upon certain events and subject to automatic extensions.

Under this agreement, GE Money Bank sets the minimum acceptable credit ratings, the interest rates, fees and all other terms and conditions of the customer accounts, including collection policies and procedures, and is the owner of the accounts. In connection with all purchases financed under these arrangements, GE Money Bank pays us an amount equal to the total amount of such purchases, net of promotional related discounts. Any increase by GE Money Bank in the minimum customer credit ratings necessary to qualify for credit could adversely impact our sales by decreasing the number of customers who can finance purchases. We are liable to GE Money Bank for charge-backs arising out of (i) breach of our warranties relating to the underlying sale transaction, (ii) defective products or (iii) our failure to comply with applicable operating procedures under the facility. We are not liable to GE Money Bank for losses arising out of our customers' credit defaults.

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We have the right to terminate the agreement in order to manage this consumer credit program internally at any time after 2008. Upon the termination of the agreement, we have the right, but not the obligation, to purchase GE Money Bank's portfolio of customer accounts.

Approximately 40% of our net sales during 2006 were financed by GE Money Bank or its predecessor, Mill Creek Bank. Consumers that do not qualify for credit under our agreement with GE Money Bank may apply for credit under a secondary program maintained by the company through another provider.

Termination of our agreement with GE Money Bank or with our secondary provider, any material change to the terms of our agreement with either of these providers, or in the availability or terms of credit for our customers from these providers, or any delay in securing replacement credit sources, could harm our business, operating results and financial condition.

Our current management information systems may not be adequate to support our growth strategy. We have recently undertaken plans to implement an SAP-based enterprise-wide information technology architecture. We currently expect this project to be completed in the first half of 2008 and we expect to incur significant increases in expenses and capital expenditures in 2007 and the remainder of the implementation phase to complete this project. This project may take longer and may require more resources to implement than anticipated, may cause distraction of key personnel, may cause disruptions to our business, and may not ultimately provide the benefits we anticipate. Any of these outcomes could impair our ability to achieve critical strategic initiatives and could significantly harm our business, operating results and financial condition.

We depend upon our management information systems for many aspects of our business. Our current information systems architecture includes some off-the-shelf programs as well as some key software that has been developed by our own programmers, which is not easily modified or integrated with other software and systems and limits the flexibility and scalability of our information systems. Our business will be materially and adversely affected if our management information systems are disrupted or if we are unable to improve, upgrade, integrate or expand our systems as we execute our growth strategy. In addition, any failure of our systems and processes to adequately protect customer information from theft or loss could materially and adversely impact our business, our reputation and our operating results.

We have recently undertaken plans to implement an integrated suite of SAP-based applications, including enterprise resources planning, customer relationship management, supply chain management, product lifecycle management, supplier relationship management, human capital management, strategic enterprise management, business intelligence and enterprise portal systems to replace many of our current systems. We believe this SAP-based IT architecture, along with best-practices-based processes and higher concentrations of off-the-shelf, packaged solutions, will provide greater flexibility and functionality for our growing and evolving business model and be less expensive to maintain over the long-term.

This project may take longer and may require more resources to implement than anticipated, may cause distraction of key personnel, may cause disruptions to our business, and may not ultimately provide the benefits we anticipate. Any of these outcomes could impair our ability to achieve critical strategic initiatives and could significantly harm our business, operating results and financial condition.

We are subject to a wide variety of government regulations. Any failure to comply with any of these regulations could be very damaging to our business, reputation and operating results. We may be required to incur significant expenses or to modify our operations in order to ensure compliance with these regulations.

We are subject to a wide variety of government regulations relating to the bedding industry or to various aspects of our business and operations, including without limitation:

- Regulations relating to the proper labeling of bedding merchandise and other aspects of product handling and sale;
- State regulations related to the proper labeling and sale of bedding products produced in part from refurbished components;
- Federal and state flammability standards applicable generally to mattresses and mattress and foundation sets, described in greater detail below;
- Environmental regulations;

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- Consumer protection and data privacy regulations;

- Regulations related to marketing and advertising claims;
- Various federal and state “do not call” or “do not mail” list requirements;
- Federal, state and foreign labor laws, including but not limited to laws relating to occupational health and safety, employee privacy, wages and hours, overtime pay, harassment and discrimination, equal opportunity, and employee leaves and benefits;
- Antitrust regulations in the United States and other jurisdictions where we may sell our products in the future;
- Import and export regulations;
- Federal and state tax laws; and
- Federal and state securities laws;

Although we believe that we are in compliance in all material respects with these regulations and have implemented a variety of measures to promote continuing compliance, regulations may change over time and we may be required to incur expenses and/or to modify our operations in order to ensure compliance with these regulations, which could harm our operating results. If we are found to be in violation of any of the foregoing laws or regulations, we could become subject to fines, penalties, damages or other sanctions, as well as potential adverse public relations, which could materially and adversely impact our business, our reputation and our operating results.

All mattresses and mattress and foundation sets, including ours, will be subject to new federal flammability standards and related regulations beginning in July 2007. Compliance with these regulations may result in increased product costs, may require modifications to our systems and operations and may increase the risk of disruptions to our business due to ongoing testing to assure compliance or regulatory inspections.

The federal Consumer Product Safety Commission has adopted a new flammability standard and related regulations to be effective nationwide in July 2007 for mattresses and mattress and foundation sets. Compliance with these requirements may result in higher materials and manufacturing costs for our products, and will require modifications to our information systems and business operations, which may also increase our costs. To the extent we are unable to offset increased costs through value engineering and similar initiatives underway, or through price increases, our operating margins may be adversely impacted. If we choose to increase prices to preserve operating margins, our unit sales volumes could be adversely impacted.

Compliance may also require more complicated manufacturing processes, which may reduce our manufacturing capacity and require us to expand our manufacturing capacity sooner than otherwise anticipated.

The new regulations require manufacturers to implement quality assurance programs to ensure compliance and encourage manufacturers to conduct random testing of products. The new regulations also require maintenance and retention of compliance documentation. These quality assurance and documentation requirements will be costly to implement and maintain. If any product testing yields results indicating that any of our products may not meet the flammability standard, or if we obtain test results or other evidence that any of our products may fail to meet the standard or that a material or process used in manufacturing could affect the test performance of our product, we may be required to temporarily cease production and distribution and/or to recall products from the field, and we may be subject to fines or penalties, any of which outcomes could substantially harm our business, reputation, operating results and financial condition. We may also face increased risks of disruptions to our business caused by regulatory inspections.

We may face exposure to product liability claims.

We face an inherent business risk of exposure to product liability claims in the event that the use of any of our products is alleged to have resulted in personal injury or property damage. In the event that any of our products proves to be defective, we may be required to recall or redesign such products. In 2004, we experienced increased returns and adverse impacts on sales as a result of media reports related to the alleged propensity of our products to develop mold. We may experience material increases in returns and material adverse impacts on sales in the event any similar media reports were to occur in the future. We maintain insurance against product liability claims, but such coverage may not continue to be available on terms

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acceptable to us and may not be adequate for liabilities actually incurred. A successful claim brought against us in excess of available insurance coverage, or any claim or product recall that results in significant adverse publicity against us, may have a material adverse effect on our business.

If we are unable to protect our intellectual property, we may be unable to prevent other companies from using our technology in competitive products.

We own various U.S. and foreign patents and patent applications related to certain elements of the design and function of our beds and related products. We also own several registered and unregistered trademarks and trademark applications, including in particular our Select Comfort and Sleep Number trademarks, which we believe have significant value and are important to the marketing of our products to customers. In addition to patents and trademarks, we rely upon copyrights, trade secrets and other intellectual property rights and we have implemented several measures to protect our intellectual property and confidential information contained in our products, such as entering into assignment of invention and nondisclosure agreements with certain of our employees. Our ability to compete effectively with other companies depends, to a significant extent, upon our ability to maintain the proprietary nature of our owned intellectual property and confidential information. Our intellectual property rights may not provide substantial protection against infringement or piracy and may be circumvented by our competitors. Our protective measures may not protect our intellectual property rights or confidential information or prevent our competitors from developing and marketing products that are similar to or competitive with our beds or other products. In addition, the laws of some foreign countries may not protect our intellectual property rights and confidential information to the same extent as the laws of the United States. If we are unable to protect our intellectual property, we may be unable to prevent other companies from using our technology or trademarks in connection with competitive products, which could adversely affect our sales or require us to decrease our prices.

Intellectual property litigation, which could result in substantial costs to us and the diversion of significant time and effort by our executive management, may be necessary to enforce our patents and trademarks and to protect our trade secrets and proprietary technology. We may not have the financial resources necessary to

enforce or defend our intellectual property rights.

We are not aware of any material intellectual property infringement or invalidity claims that may be asserted against us, however, it is possible that third parties, including competitors, may successfully assert such claims. The cost of defending such claims, or any resulting liability, or any failure to obtain necessary licenses on reasonable terms, may adversely impact our operating results and financial condition.

The loss of the services of any members of our executive management team could materially and adversely impact our ability to execute our business strategy and growth initiatives and could significantly harm our business.

We are currently dependent upon the continued services, ability and experience of our executive management team, particularly William R. McLaughlin, our Chairman and Chief Executive Officer. The loss of the services of Mr. McLaughlin or any other member of our executive management team could have a material adverse effect on our ability to execute our business strategy and growth initiatives and on our results of operation and financial condition. We do not maintain any key person life insurance on any members of our executive management team. Our future growth and success will also depend upon our ability to attract, retain and motivate other qualified personnel.

Additional terrorist attacks in the United States or against U.S. targets or actual or threats of war or the escalation of current hostilities involving the United States or its allies could significantly impact our business, financial condition, operating results or stock price in unpredictable ways.

Additional terrorist attacks in the United States or against U.S. targets, or threats of war or the escalation of current hostilities involving the United States or its allies, or military or trade disruptions impacting our domestic or foreign suppliers of components of our products, may impact our operations, including, but not limited to, causing delays or losses in the delivery of merchandise to us and decreased sales of our products. These events could cause an increase in oil or other commodity prices, which could adversely affect our materials or transportation costs, including delivery of our products to customers. More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and worldwide financial markets. These events also could cause an economic recession in the United States or abroad. Any of these occurrences could have a significant impact on our business, operating results and financial condition and may result in volatility of our stock price.

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An outbreak of Avian Flu or a pandemic, or the threat of a pandemic, may adversely impact our ability to produce and deliver our products or may adversely impact consumer demand.

Concern has grown recently over the possibility of a significant or global outbreak of avian flu or a similar pandemic. A significant outbreak of avian flu, or a similar pandemic, or even a perceived threat of such an outbreak, could cause significant disruptions to our supply chain, manufacturing capability and distribution system that could adversely impact our ability to produce and deliver products, which could result in a loss of sales and an adverse impact on our results of operations and financial condition. Similarly, such events could cause significant adverse impacts on consumer confidence and consumer demand generally, which could significantly and adversely impact our sales, results of operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

Distribution Locations

We currently lease all of our existing retail store locations and expect that our policy of leasing, rather than owning stores, will continue as we expand our store base. Our store leases generally provide for an initial lease term of five to 10 years with a mutual termination option if we do not achieve certain minimum annual sales thresholds. Generally, the store leases require us to pay minimum rent plus percentage rent based on net sales in excess of certain thresholds, as well as certain operating expenses.

The following table summarizes the geographic location of our 442 company-owned stores and 822 retail partner doors as of December 30, 2006:

	Company-Owned Stores	Retail Partner Doors		Company-Owned Stores	Retail Partner Doors
Alabama	3	-	Montana	2	2
Alaska	-	3	Nebraska	3	4
Arizona	8	34	Nevada	4	-

Arkansas	2	-	New Hampshire	5	-
California	51	132	New Jersey	14	24
Colorado	14	1	New Mexico	2	-
Connecticut	8	26	New York	17	105
Delaware	2	-	North Carolina	12	30
Florida	29	33	North Dakota	1	7
Georgia	14	27	Ohio	16	16
Hawaii	-	6	Oklahoma	3	5
Idaho	1	-	Oregon	5	-
Illinois	18	3	Pennsylvania	20	2
Indiana	10	8	Rhode Island	1	-
Iowa	6	13	South Carolina	5	3
Kansas	5	7	South Dakota	2	10
Kentucky	4	1	Tennessee	10	13
Louisiana	4	4	Texas	34	109
Maine	2	-	Utah	4	-
Maryland	10	6	Vermont	1	-
Massachusetts	11	7	Virginia	13	1
Michigan	13	-	Washington	13	-
Minnesota	16	33	West Virginia	1	-
Mississippi	-	-	Wisconsin	10	15
Missouri	13	13	Wyoming	-	-
			Canada	-	119
			Total	442	822

Manufacturing and Headquarters

We lease approximately 122,000 square feet in Minneapolis, Minnesota that includes our corporate headquarters, our direct marketing call center, our customer service group, our research and development department, and a distribution center that accepts returns and processes warranty claims. This lease expires in 2017 and contains one five-year renewal option. We sublease approximately 18,000 square feet in Minneapolis for a home delivery distribution center and a portion of our corporate headquarters staff. This sublease expires in December 2007 with no renewal option. We also sublease approximately 29,000 square feet in Minneapolis for our information technology department and a portion of our corporate headquarters staff. This sublease expires in February 2008 and contains one two-year renewal option.

To better meet our anticipated future space needs, we entered into a lease agreement with Opus Northwest, L.L.C. (“Opus”) in July 2006, pursuant to which Opus will build our new 160,000-square-foot corporate headquarters. The new facility is expected to be completed during the second half of 2007 at which time the lease will commence and run for an initial term of 10 years with two five-year renewal options. We plan to continue to use our existing headquarters facility for our direct marketing call center, our customer service call center, our research and development department, and for processing returns and warranty claims and accessories.

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We lease two manufacturing and distribution centers in Irmo, South Carolina and Salt Lake City, Utah of approximately 105,000 square feet and approximately 101,000 square feet, respectively. We lease the Irmo facility through February 2008, with a five-year renewal option thereafter, and the Salt Lake City facility through April 2009, with a five-year renewal option thereafter.

To support our program with Radisson Hotels and Resorts, we lease approximately 40,000 square feet in Omaha, Nebraska, through July 2007. This lease also has two one-year renewal options.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various legal proceedings arising in the ordinary course of business. In the opinion of management, any losses that may occur from these matters are adequately covered by insurance or are provided for in our consolidated financial statements if the liability is probable and estimable in accordance with generally accepted accounting principles. The ultimate outcome of these matters are not expected to have a material effect on our consolidated results of operations or financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on The NASDAQ Stock Market LLC (NASDAQ Global Select Market) under the symbol "SCSS." As of February 9, 2007, there were approximately 187 holders of record of our common stock. The following table sets forth the quarterly high and low sales prices per share of our common stock as reported by NASDAQ for the two most recent fiscal years, adjusted for a three-for-two stock split that became effective on June 8, 2006. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Fiscal 2006				
High	$ 25.25	$ 24.28	$ 28.52	$ 27.50
Low	16.83	17.36	20.28	17.46
Fiscal 2005				
High	$ 19.17	$ 15.04	$ 16.49	$ 15.17
Low	11.55	12.28	12.12	11.06

Select Comfort has not historically paid cash dividends on its common stock and has no current plans to pay cash dividends.

Information concerning stock repurchases completed during the fourth quarter of fiscal 2006 is set forth below:

Fiscal Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 2006	72,873	$ 21.69	72,873	
November 2006	675,000	20.80	675,000	
December 2006	824,518	17.71	824,518	$ 88,674,000
Total	1,572,391	19.22	1,572,391	

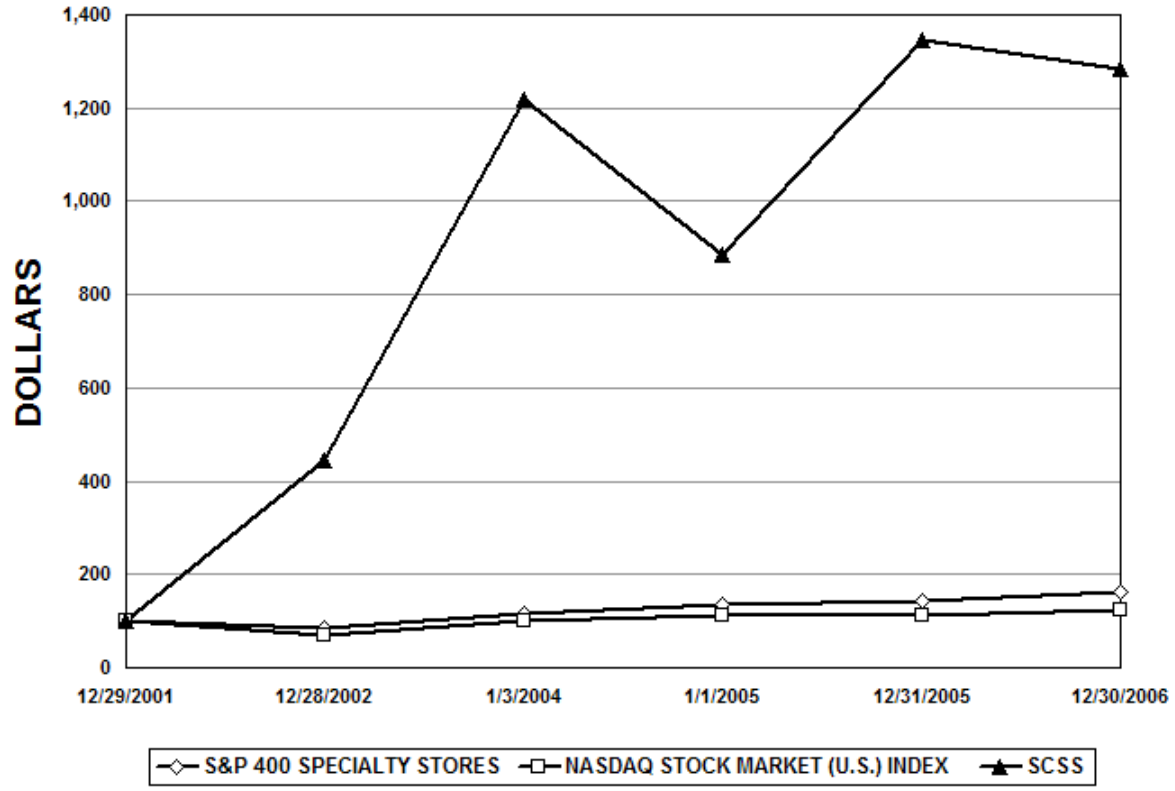
(1) Includes 79 shares acquired in open market transactions by the administrator of the Company's non-qualified deferred compensation plan in order to accommodate investment elections of plan participants.

(2) On May 15, 2006, the Company announced that the Board of Directors approved a $150 million share repurchase program. The Finance Committee of the Board of Directors reviews repurchases under this program on a quarterly basis. The repurchase authorization expires at the end of 2008. As of February 9, 2007, the total outstanding authorization was $59.4 million.

Comparative Stock Performance

The graph below compares the total cumulative shareholder return on our common stock over the last five years to the total cumulative return on the Standard and Poor's ("S&P") 400 Specialty Stores Index and The NASDAQ Stock Market (U.S.) Index assuming a $100 investment made on December 29, 2001. Each of the three measures of cumulative total return assumes reinvestment of dividends. The stock performance shown on the graph below is not necessarily indicative of future price performance. This graph is being "furnished" and not "filed."

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN
AMONG SELECT COMFORT CORPORATION, S&P 400 SPECIALTY STORES INDEX,
AND THE NASDAQ STOCK MARKET (U.S.) INDEX



	12/29/2001	12/28/2002	1/3/2004	1/1/2005	12/31/2005	12/30/2006
Select Comfort Corporation	$ 100	$ 446	$ 1,217	$ 884	$ 1,347	$ 1,285
S&P 400 Specialty Stores Index	100	85	116	136	143	161
The NASDAQ Stock Market (U.S.) Index	100	68	102	110	113	124

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Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information about our equity compensation plans as of December 30, 2006:

EQUITY COMPENSATION PLAN INFORMATION

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 the first column)
Equity compensation plans approved by security holders (1)	5,540,000	$11.43	1,964,000
Equity compensation plans not approved by security holders	None	Not applicable	None
Total	5,540,000	$11.43	1,964,000

(1) Includes the Select Comfort Corporation 1990 Omnibus Stock Option Plan, the Select Comfort Corporation 1997 Stock Incentive Plan and the Select Comfort Corporation 2004 Stock Incentive Plan, as adjusted for our 2006 stock split.

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ITEM 6. SELECTED FINANCIAL DATA
(in thousands, except per share and selected operating data, unless otherwise indicated)

The Consolidated Statements of Operations Data and Consolidated Balance Sheet Data presented below have been derived from our Consolidated Financial Statements and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Consolidated Financial Statements and Notes thereto included in this Annual Report.

Certain reclassifications were made to prior period consolidated statements of operations and consolidated statements of financial position data in order to conform to the current-year presentation. These reclassifications had no impact on consolidated net income or retained earnings as previously reported. For additional information regarding these reclassifications, see Note 1 of the Notes to the Consolidated Financial Statements included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K.

	Year					
	2006 (1)	2005	2004	2003 (2)	2002	2001
Consolidated Statements of Operations Data:						
Net sales	$ 806,038	$ 689,548	$ 557,639	$ 458,489	$ 335,795	$ 261,687
Gross profit	490,508	406,476	339,838	285,324	208,663	154,180
Operating expenses:						
Sales and marketing	341,630	286,206	250,628	207,400	156,307	138,496
General and administrative	65,401	49,300	37,826	33,974	30,123	23,834
Research and development	4,687	2,219	1,853	1,295	936	1,086
Asset impairment charges	5,980	162	—	71	233	1,366
Operating income (loss)	72,810	68,589	49,531	42,584	21,064	(10,602)
Net income (loss)	$ 47,183	$ 43,767	$ 31,555	$ 27,102	$ 37,466	$ (12,066)
Net income (loss) per share:						
Basic	$ 0.89	$ 0.82	$ 0.58	$ 0.55	$ 1.02	$ (0.44)
Diluted	0.85	0.76	0.53	0.46	0.72	(0.44)
Shares used in calculation of net income (loss) per share:						
Basic	52,837	53,357	54,015	49,157	36,824	27,236
Diluted	55,587	57,674	59,525	58,916	51,798	27,236
Consolidated Balance Sheet Data:						
Cash, cash equivalents and marketable securities	$ 90,175	$ 123,091	$ 101,963	$ 75,118	$ 40,824	$ 16,375
Working capital	5,637	10,158	23,479	53,972	27,064	(3,739)
Total assets	228,961	239,838	202,033	153,506	108,633	67,436
Long-term debt, less current maturities	—	—	—	—	2,991	17,109
Total shareholders' equity	115,694	121,347	114,344	92,201	54,024	5,937
Selected Operating Data:						
Stores open at period-end (3)	442	396	370	344	322	328
Stores opened during period	51	40	31	27	15	11
Stores closed during period	5	14	5	5	21	16
Retail partner doors	822	353	89	77	71	—
Average net sales per store (000's) (4)	$ 1,493	$ 1,417	$ 1,247	$ 1,101	$ 817	$ 626
Percentage of stores with more than $1.0 million in net sales (4)	81%	77%	64%	49%	24%	10%
Comparable-store sales increase (decrease) (5)	7%	15%	16%	31%	27%	(4)%
Average square footage per store open during period (4)	1,200	1,121	1,032	990	972	941
Net sales per square foot (4)	$ 1,244	$ 1,264	$ 1,208	$ 1,113	$ 841	$ 666
Average store age (in months at period end)	81	79	75	70	61	51

(1) In the first quarter of fiscal 2006, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R, "*Share-Based Payment*," requiring us to recognize expense related to the fair value of our stock-based compensation awards. We elected the modified prospective transition method as permitted by SFAS 123R and, accordingly, financial results for fiscal years prior to 2006 have not been restated. Stock-based compensation expense for fiscal 2006 was $8,325 ($5,687 net of tax). Prior to the adoption of SFAS 123R, the Company followed the intrinsic value method in accordance with Accounting Principles Board ("APB") Opinion No. 25, "*Accounting for Stock Issued to Employees*," to account for its employee stock options and employee stock purchase plan. Accordingly, no compensation expense was recognized for share purchase rights granted in connection with the issuance of stock options under the Company's employee stock option plan or employee stock purchase plan; however, compensation expense was recognized in connection with the issuance of restricted and performance shares granted. See Note 7 of the Notes to the Consolidated Financial Statements for additional information regarding stock-based compensation. Stock-based compensation expense (pre-tax) recognized in our financial results for years prior to fiscal 2006 were $793, $405, and $76 in 2005, 2004, 2003, respectively; and none in 2002 and 2001.

(2) Fiscal year 2003 had 53 weeks. All other fiscal years presented had 52 weeks.

(3) Includes stores operated in leased departments within other retail stores (none in 2006 and 2005; 13 in 2004, 2003 and 2002; and 22 in 2001).

(4) For stores open during the entire period indicated.

(5) Stores are included in the comparable-store calculation in the 13th full month of operation. Stores that have been remodeled or relocated within the same shopping center remain in the comparable-store base. The number of comparable-stores used to calculate such data was 391, 354, 339, 316, 307 and 317 for

2006, 2005, 2004, 2003, 2002 and 2001, respectively. Our 2004 and 2003 comparable-store sales increase reflects adjustments for an additional week of sales in 2003. Without adjusting for the additional week, comparable-store sales would have been 14% for 2004 and 34% for 2003.

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

Forward-Looking Statements

The discussion in this Annual Report contains certain forward-looking statements that relate to future plans, events, financial results or performance. You can identify forward-looking statements by those that are not historical in nature, particularly those that use terminology such as "may," "will," "should," "could," "expect," "anticipate," "believe," "estimate," "plan," "project," "predict," "intend," "potential," "continue" or the negative of these or similar terms. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. These risks and uncertainties include, among others, such factors as general and industry economic trends, uncertainties arising from global events, consumer confidence, effectiveness of our advertising and promotional efforts; our ability to secure suitable retail locations, our ability to attract and retain qualified sales professionals and other key employees; consumer acceptance of our products, product quality, innovation and brand image, our ability to continue to expand and improve our product line; industry competition; warranty expenses; the outcome of pending litigation, including consumer class action litigation; our dependence on significant suppliers, and the vulnerability of any suppliers to recessionary pressures, labor negotiations, liquidity concerns or other factors; rising commodity costs; and increasing government regulations, including new flammability standards for the bedding industry. Additional information concerning these and other risks and uncertainties is contained under the caption "Risk Factors" in this Annual Report on Form 10-K.

Overview

Select Comfort is the leading developer, manufacturer and marketer of premium-quality, adjustable-firmness beds. The air-chamber technology of our proprietary Sleep Number® bed allows adjustable firmness on each side of the mattress and provides a sleep surface that is clinically proven to provide better sleep quality and greater relief of back pain compared to traditional mattress products. In addition, we market and sell accessories and other sleep related products which focus on providing personalized comfort to complement the Sleep Number bed and provide a better night's sleep to the consumer.

We generate revenue by selling our products through four complementary distribution channels. Three of these channels: retail, direct marketing and e-commerce, are company-controlled and sell directly to consumers. Our wholesale channel sells to leading home furnishings retailers, specialty bedding retailers, the QVC shopping channel and to several end users such as Radisson Hotels and Resorts®.

The proportion of our total net sales, by dollar volume, from each of our channels during the last three years is summarized as follows:

	2006	2005	2004
Retail	76.2%	76.9%	78.0%
Direct	9.4%	10.8%	11.5%
E-commerce	5.6%	5.0%	4.6%
Wholesale	8.8%	7.3%	5.9%
Total	100.0%	100.0%	100.0%

The components of total sales growth, including comparable-store sales increases, are as follows:

	2006 Channel increase	2005 Channel increase	2004 Channel increase
Retail:			
Comparable-store(1) sales	7%	15%	16%
New/closed stores, net	9%	7%	8%
Retail total	16%	22%	24%
Direct	1%	16%	10%
E-commerce	31%	34%	34%
Wholesale	40%	54%	73%
Total sales growth	17%	24%	22%

(1) Stores are included in the comparable-store calculation in the 13th full month of operation. Stores that have been remodeled or relocated within the same shopping center remains in the comparable-store base.

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The number of company-operated retail stores during the last three years, and independently owned and operated retail partner stores are summarized as follows:

	2006	2005	2004
Company-owned retail stores:			

Beginning of year	396	370	344
Opened	51	40	31
Closed	(5)	(14)	(5)
End of year	442	396	370
Retail partner stores	822	353	89

We anticipate opening 40 net new retail stores and to relocate or expand 30 or more stores in 2007. We expect the number of stores in our retail partner program to remain at approximately 800 in 2007.

Our growth plans are centered on increasing market-by-market awareness of our products and stores through expansion of media, increasing distribution – primarily through new retail store openings and supplemented with sales through other mattress retailers, and through improvement and expansion of our product lines. Our primary market consists of the sale of products directly to consumers in the U.S. We believe long-term opportunities exist for international sales. In December 2005, we entered the Canadian market through a retail partner with locations in major metropolitan markets.

Sales growth and a higher gross profit rate enabled us to increase operating income by 6% in 2006. Historically, the majority of our operating margin improvement has been generated through leverage in selling expenses (increased sales through the existing store base) and leverage of our existing infrastructure (general and administrative expenses). We expect any future improvements in operating margin to be derived from similar sources. Our long-term growth targets are to sustain annual sales growth rates of 15% or more and annual earnings growth rates of 20% or more. We expect a challenging economic environment in 2007 which may affect our ability to achieve these targets in 2007.

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RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, our results of operations expressed as dollars and percentages of net sales. Figures are in millions except percentages and earnings per share amounts. Amounts may not add due to rounding differences.

	2006		2005		2004	
	$	% of Net Sales	$	% of Net Sales	$	% of Net Sales
Net sales	$ 806.0	100.0%	$ 689.5	100.0%	$ 557.6	100.0%
Cost of sales	315.5	39.1	283.1	41.1	217.8	39.1
Gross profit	490.5	60.9	406.5	58.9	339.8	60.9
Operating expenses:						
Sales and marketing	341.6	42.4	286.2	41.5	250.6	44.9
General and administrative	65.4	8.1	49.3	7.1	37.8	6.8
Research and development	4.7	0.6	2.2	0.3	1.9	0.3
Asset impairment charges	6.0	0.7	0.2	0.0	0.0	0.0
Total operating expenses	417.7	51.8	337.9	49.0	290.3	52.1
Operating income	72.8	9.0	68.6	9.9	49.5	8.9
Interest income	3.0	0.4	2.2	0.3	1.4	0.3
Income before income taxes	75.8	9.4	70.8	10.3	50.9	9.1
Income tax expense	28.6	3.6	27.0	3.9	19.4	3.5
Net income	$ 47.2	5.9%	$ 43.8	6.3%	$ 31.6	5.7%

	2006	2005	2004
Net income per share:			
Basic	$ 0.89	$ 0.82	$ 0.58
Diluted	0.85	0.76	0.53
Weighted-average number of common shares:			
Basic	52.8	53.4	54.0
Diluted	55.6	57.7	59.5

Net Sales

We recognize revenue when the sales price is fixed or determinable, collectibility is reasonably assured and title passes. We reduce sales at the time revenue is recognized for estimated returns. This estimate is based on historical return rates, which are reasonably consistent from period to period, and adjusted for any current trends as appropriate. If actual returns vary from expected rates, revenue in future periods is adjusted. Historically, we have not experienced material adjustments to the financial statements due to changes to estimates of returns.

Cost of Sales

Cost of sales includes costs associated with purchasing, manufacturing, shipping, handling and delivering our products to our customers, including related occupancy and depreciation expenses. Cost of sales also includes estimated costs to service warranty claims of customers. This estimate is based on historical claim rates experienced during the warranty period and adjusted for any current trends as appropriate. Because this estimate covers an extended period of time, a revision of estimated claim rates could result in a significant adjustment of estimated future costs of fulfilling warranty commitments and could have a material

adverse effect on future results of operations. We revise our estimates of warranty liabilities to reflect changes in projected claim rates and projected costs of fulfilling warranty claims. However, these estimate revisions have not historically materially affected our annual results.

Gross Profit

Our gross profit margin is dependent on a number of factors and may fluctuate from quarter to quarter. These factors include the mix of products sold, the level at which we offer promotional discounts to purchase our products, the cost of materials, delivery and manufacturing and the mix of sales between wholesale and company-controlled distribution channels. Sales of products manufactured by third parties, such as accessories and our adjustable foundation, generate lower gross margins. Similarly, sales directly to consumers through company-controlled channels typically generate higher gross margins than sales through our wholesale channels because we capture both the manufacturer's and retailer's margin.

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Sales and Marketing Expenses

Sales and marketing expenses include advertising and media production, other marketing and selling materials such as brochures, videos, customer mailings and in-store signage, sales compensation, customer service, store occupancy costs and related depreciation expense.

Advertising expense was $105.3 million in 2006, $89.4 million in 2005, and $78.5 million in 2004. Future advertising expenditures will depend on the effectiveness and efficiency of the advertising in creating awareness of our products and brand names, generating consumer inquiries and driving consumer traffic to our points of sale. We anticipate that full-year advertising expenditures in 2007 will increase by approximately 10%.

General and Administrative Expenses

General and administrative expenses consist of costs associated with management of functional areas, including information technology, human resources, finance, sales and marketing administration, investor relations and risk management. Costs include salaries, bonus and benefits, information hardware, software and maintenance, office facilities, insurance, investor relations costs and other overhead.

Research and Development Expenses

Research and development ("R&D") expenses includes internal labor and benefits, outside consulting services and testing equipment. R&D spending is expected to increase by up to 50% in 2007 as we accelerate our innovation, leading with a series of cost and quality enhancements for our products.

Asset Impairment Charges

Asset impairment charges relate to long-lived assets that have been written-off when the carrying amount of an asset is not expected to be recoverable from future cash flows. We evaluate our long-lived assets, including leaseholds and fixtures in existing stores, based on estimated future cash flows after considering the potential impact of planned operational improvements, marketing programs, industry economic factors and the profitability of future business strategies. Expected cash flows may not be realized, which could cause long-lived assets to become impaired in future periods and could have a material adverse effect on future results of operations.

Quarterly and Annual Operating Results

Quarterly and annual operating results may fluctuate significantly as a result of a variety of factors, including increases or decreases in comparable-store sales, the timing, amount and effectiveness of advertising expenditures, any changes in sales return rates or warranty experience, the timing of new store openings and related expenses, net sales contributed by new stores, the timing of promotional offerings, competitive factors, rising commodity costs, any disruptions in supplies or third-party services, seasonality of retail sales, timing of QVC shows and wholesale sales, consumer confidence and general economic conditions. Furthermore, a substantial portion of net sales is often realized in the last month of a quarter, due in part to our promotional schedule and commission structure. As a result, we may be unable to adjust spending in a timely manner and our business, financial condition and operating results may be significantly impacted. Our historical results of operations may not be indicative of the results that may be achieved for any future period.

Comparison of 2006 and 2005

Net Sales

Net sales in 2006 increased 17% to $806.0 million from $689.5 million in 2005. Sales of mattress units increased 9% overall, and the average selling price per bed (mattress sales divided by mattress units) in our company-controlled channels increased 6% to $1,699, while sales of other products and services increased by 24%. The higher average selling price per bed resulted primarily from a price increase in late 2005 and a shift in the net sales mix to higher priced mattress models.

The $116.5 million increase in net sales was attributable to (i) an $84.4 million increase in net sales from our retail stores, including an increase in comparable-store sales of $36.9 million and an increase of $47.5 million from new stores, net of stores closed, (ii) a $1.1 million increase in direct marketing net sales, (iii) a $10.9 million increase in net sales from our e-commerce channel, and (iv) a $20.1 million increase in net sales from our wholesale channel.

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Gross Profit

Gross profit increased to 60.9% in 2006 from 58.9% in 2005, primarily due to higher average selling prices of mattresses and productivity improvements in manufacturing and logistics which reduced the Company's cost of sales. This was partially offset by an increase in the percentage of net sales from lower margin channels which reduced the gross profit rate by 0.4 percentage points (ppt) and a correction in warranty liabilities to include freight costs which had not been included in prior periods. This correction was immaterial to current and prior periods.

Sales and Marketing Expenses

Sales and marketing expenses in 2006 increased 19% to $341.6 million from $286.2 million in 2005 and increased as a percentage of net sales to 42.4% from 41.5% for the comparable prior-year period. The $55.4 million increase was primarily due to additional media investments, increased number of stores and markets served, and an increase in variable costs due to higher sales. The 0.9 ppt increase as a percentage of net sales was primarily due to a 0.7 ppt of net sales increase in financing, promotion and other marketing costs. We generally expect sales and marketing expense growth rates to be lower than the rate of net sales growth due to leveraging the fixed component of sales and marketing expenses across a higher sales base, while reinvesting some of these leverage benefits into higher levels of media investments.

General and Administrative Expenses

General and administrative (G&A) expenses increased 33% to $65.4 million in 2006 from $49.3 million in 2005 and increased as a percentage of net sales to 8.1% from 7.1% for the comparable prior-year period. The dollar and percentage increases in G&A were primarily due to increased compensation costs related to the adoption of SFAS 123R which required the expensing of $5.5 million (0.7 ppt) of stock option compensation, increased compensation and benefits expenses related to additional headcount of $4.9 million, higher professional fees of $2.9 million, and additional depreciation and maintenance expense from information technology infrastructure investments of $2.5 million, partially offset by lower incentive compensation costs of $2.5 million resulting from our all-employee incentive compensation program. We generally expect future G&A growth rates to be lower than the rate of sales growth due to leveraging the fixed component of G&A expenses across a higher sales base.

Research and Development

Research and development expenses increased $2.5 million to $4.7 million in 2006 from $2.2 million in 2005 and increased as a percentage of net sales to 0.6% from 0.3% for the comparable prior-year period. The significant dollar and percentage increases in R&D expenses in fiscal year 2006 was due to our strategic decision to accelerate our investment in new product innovation.

Asset Impairment Charges

Asset impairment charges increased to $6.0 million in 2006 from $0.2 million in 2005. The charges in 2006 relate primarily to the $5.4 million write-off of software projects abandoned in connection with our decision to implement a new SAP® enterprise resource planning system. In addition, the charges in 2006 include $0.6 million associated with store asset impairments.

Interest Income

Interest income increased $0.8 million to $3.0 million in 2006 from $2.2 million in 2005. The increase in interest income resulted from higher interest rates on invested balances.

Income Tax Expense

Income tax expense increased $1.6 million to $28.6 in 2006 from $27.0 in 2005 principally due to the increase in pre-tax income. The effective tax rates were 37.8% in 2006 and 38.1% in 2005. The decrease in the effective tax rate was principally due to increased interest income from tax-exempt securities.

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Comparison of 2005 and 2004

Net Sales

Net sales in 2005 increased 24% to $689.5 million from $557.6 million in 2004. Sales of mattress units increased 19% overall, and the average selling price per bed (mattress sales divided by mattress units) in our company-controlled channels increased 5% to $1,597, while sales of other products and services increased by 28%. The higher average selling price resulted primarily from a price increase introduced at the beginning of 2005 and improvements in product mix. The increase in mattress unit sales was driven primarily by growth in same-store sales and distribution expansion.

The increase in net sales by sales channel was attributable to (i) a $94.9 million increase in net sales from our retail stores, including an increase in comparable-store sales of $64.9 million and an increase of $30.0 million from new stores, net of stores closed, (ii) a $10.4 million increase in direct marketing net sales, (iii) an $8.9 million increase in net sales from our e-commerce channel, and (iv) a $17.7 million increase in net sales from our wholesale channel.

Gross Profit

Gross profit decreased to 58.9% in 2005 from 60.9% in 2004, primarily due to changes in channel mix (i.e., increased percentage of total net sales from lower margin channels), higher warranty expense, and increased product and delivery costs resulting from rising commodity and fuel costs, offset partially by sales price increases and favorable sales return rates.

Sales and Marketing Expenses

Sales and marketing expenses in 2005 increased 12% to $286.2 million from $250.6 million in 2004 and decreased as a percentage of net sales to 41.5% from 44.9% for the comparable prior-year period. The $35.6 million increase was primarily due to additional media investments, increased number of stores and increased variable costs due to higher sales. The decrease as a percentage of net sales was comprised primarily of a 1.1 ppt increase in leverage of media investments, 0.6 ppt of other marketing leverage and a 1.7 ppt leverage of fixed costs (occupancy, base sales compensation and certain marketing expenses) over higher sales.

General and Administrative Expenses

General and administrative (G&A) expenses in 2005 increased 30% to $49.3 million from $37.8 million in 2004 and increased as a percentage of net sales to 7.1% from 6.8% for the comparable prior-year period. The dollar increase in G&A was primarily due to increased incentive compensation expense of $6.5 million resulting from our all-employee incentive compensation program, increased compensation and benefits expenses related to additional headcount of $3.4 million, increased professional fees of $2.7 million, and $1.0 million in additional depreciation and maintenance expense from information technology infrastructure investments.

Research and Development

Research and development expenses increased $0.3 million to $2.2 million in 2005 from $1.9 million in 2004.

Interest Income

Interest income increased $0.8 million to $2.2 million in 2005 from $1.4 million in 2004. The increase in interest income resulted from higher average balances of invested cash and higher interest rates.

Income Tax Expense

Income tax expense increased $7.6 million to $27.0 in 2005 from $19.4 in 2004 principally due to higher pre-tax income. The effective tax rate was 38.1% in both 2005 and 2004.

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Liquidity and Capital Resources

As of December 30, 2006, we had cash, cash equivalents and marketable securities of $90.2 million, of which $46.6 million was classified as a current asset compared to $123.1 million of cash, cash equivalents and marketable securities as of December 31, 2005, of which $68.0 million was classified as a current asset. The $32.9 million decrease in cash, cash equivalents and marketable securities was the result of $59.4 million of cash provided by operating activities, reduced by $31.1 million of capital expenditures and $61.2 million of cash used in financing activities (which included $77.2 million of repurchases of our common stock, net of cash from stock option exercises and related tax benefits).

We generated cash from operations of $59.4 million in 2006. Cash from operations for 2006 is comprised of net income of $47.2 million, plus adjustments to reconcile net income to cash provided by operating activities of $17.7 million, and a decrease in cash from changes in assets and liabilities of $5.5 million, due primarily to increases in accounts receivable and inventory combined with decreases in customer prepayments and accrued compensation and benefits, partially offset by increases in accounts payable. Cash from operations for 2005 was $87.5 million, $28.1 million more than 2006. Cash from operations in 2005 is comprised of net income of $43.8 million, $3.4 million less than 2006; adjustments to reconcile net income to cash provided by operating activities of $15.4 million, $2.3 million less than 2006 due primarily to increases in asset impairment charges taken in 2006; and an increase in cash from changes in assets and liabilities of $28.4 million primarily due to increases in accrued compensation and other current liabilities in excess of changes in current assets.

Net cash used in investing activities was $33.2 million and $28.4 million in 2006 and 2005, respectively. The increase in net cash used in investing activities was principally due to a $5.2 million increase in capital expenditures. In both periods, our capital expenditures were primarily related to new and remodeled retail stores and investments in information technology. In 2006, we opened 51 new stores and remodeled 28 retail stores, while in 2005 we opened 40 new stores and remodeled 11 retail stores. We anticipate increasing our retail store count by 40 net new retail stores during 2007, and relocating or expanding 30 or more stores in 2007. We will fund planned capital expenditures with cash on hand and cash generated from operations. We expect our new stores to be cash flow positive within the first 12 months of operations and, as a result, do not anticipate a negative effect on net cash needs. Our 2007 capital expenditures are expected to be approximately $50 million, compared to $31.1 million in 2006. The increase in capital expenditures is due to our expected implementation of SAP in the first half of fiscal year 2008 and leasehold improvement costs necessary to furnish our new corporate headquarters that we plan to move into in the fall of 2007.

Net cash used in financing activities was $61.2 million in 2006, compared to $40.5 million in 2005. The $20.7 million increase in cash used in financing activities resulted from a $27.5 million increase in repurchases of our common stock, offset by the change in the classification of the excess tax benefits from stock option exercises of $8.6 million from operating to financing in accordance with adoption of SFAS 123R in 2006. The use of cash for financing activities in both 2006 and 2005 was principally due to repurchases of our common stock of $77.2 million in 2006 and $49.7 million in 2005. We may make additional purchases of our common stock, subject to market conditions and at prevailing market prices, through open market purchases. The total outstanding stock repurchase authorization at February 9, 2007 was $59.4 million. We may terminate or limit the stock repurchase program at any time.

Cash generated from operations should be a sufficient source of liquidity for the short- and long-term and should provide adequate funding for capital expenditures. In addition, our business model, which can operate with minimal working capital, does not require significant additional capital to fund operations and organic growth. In 2006, we obtained a $100 million bank revolving line of credit for general corporate purposes including the funding of any short-term cash needs or investment opportunities. This line of credit is a five-year senior unsecured revolving facility expiring June 2011. Borrowings under the credit facility bear interest at a floating rate and may be maintained as base rate loans (tied to the prime rate or the federal funds rate plus 0.5%) or as Eurocurrency rate loans tied to LIBOR, plus a margin up to 1.0% depending on our leverage ratio, as defined. We are subject to certain financial covenants under the agreement, principally consisting of interest coverage and leverage ratios. We have remained and expect to remain in full compliance with the financial covenants. Although the Company had no borrowings against the credit facility as of December 30, 2006, we expect to incur borrowings during 2007 as we continue to repurchase our common stock at a rate that on a short-term basis may exceed the maturities of our held-to-maturity marketable securities portfolio.

Other than operating leases, we do not have any off-balance-sheet financing. A summary of our operating lease obligations by fiscal year is included in the "Contractual Obligations" section below. Additional information regarding our operating leases is available in Item 2, *Properties*, and Note 5, *Leases*, of the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K.

Contractual Obligations

The following table presents information regarding our contractual obligations by fiscal year (in thousands):

	Payments Due by Period				
	Total	**< 1 Year**	**1 – 3 Years**	**3 – 5 Years**	**> 5 Years**
Operating leases	$ 155,304	$ 28,429	$ 53,927	$ 38,019	$ 34,929
Inventory purchase commitments	325,000	122,000	153,000	50,000	—
Total	$ 480,304	$ 150,429	$ 206,927	$ 88,019	$ 34,929

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions. Predicting future events is inherently an imprecise activity and as such requires the use of judgment. Actual results may vary from estimates in amounts that may be material to the financial statements. The accounting policies discussed below are considered critical because changes to certain judgments and assumptions inherent in these policies could materially affect the financial statements.

Our critical accounting policies relate to revenue recognition, sales returns, warranty liabilities, asset impairment charges and stock-based compensation.

Revenue Recognition

We recognize revenue when the sales price is fixed or determinable, collectibility is reasonably assured and title passes. Amounts billed to customers for delivery and set up are included in net sales.

Sales Returns

We reduce sales at the time revenue is recognized for estimated returns. This estimate is based on historical return rates, which are reasonably consistent from period to period. If actual returns vary from expected rates, revenue in future periods is adjusted, which could have a material adverse effect on future results of operations.

Warranty Liabilities

The estimated cost to service warranty claims of customers is included in cost of sales. This estimate is based on historical trends of warranty claims. Because our warranty obligations cover an extended period of time, a revision of estimated claim rates or the projected cost of materials and freight associated with sending replacement parts to customers could have a material adverse effect on future results of operations.

Asset Impairment Charges

We evaluate our long-lived assets for impairment based on estimated future cash flows after considering the potential impact of planned operational improvements, marketing programs, industry economic factors and the profitability of future business strategies. Expected cash flows may not be realized, which could cause long-lived assets to become impaired in future periods and could have a material adverse effect on future results of operations. If the carrying amount of an asset exceeds its estimated cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds its fair value.

Stock-Based Compensation

Effective January 1, 2006, we changed our accounting for stock options in accordance with SFAS 123R to the fair value method and now recognize stock option compensation expense in the consolidated financial statements. The valuation of stock options and resulting compensation expense is determined using the Black-Scholes-Merton option-pricing model with the most significant inputs into the model being exercise price, our estimate of expected stock price volatility and the

weighted average expected life of the options. Previously, two alternative methods existed for accounting for stock options: the intrinsic value method and the fair value method. Prior to fiscal 2006, we used the intrinsic value method of accounting for stock options and accordingly, no compensation expense was recognized in the financial statements for options granted to employees, or for the discount feature of our employee stock purchase plan. This change in accounting policy had a material impact on our consolidated results of operations and earnings per share.

Recent Accounting Pronouncements

In May 2005, the FASB issued Statement of Financial Accounting Standard's ("SFAS") No. 154, "*Accounting Changes and Error Corrections*," which supersedes Accounting Principles Board ("APB") Opinion No. 20, "*Accounting Changes*," and FASB Statement No. 3, "*Reporting Accounting Changes in Interim Financial Statements*." SFAS 154 requires retrospective application of changes in accounting principles to prior period financial statements as of the earliest date practicable. This statement also redefines "restatement" as the revising of previously issued financial statements to reflect the correction of an error. The provisions of SFAS 154 were effective for the Company in fiscal year 2006. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "*Accounting for Uncertainty in Income Taxes*." FIN 48 defines the threshold for recognizing the benefits of tax positions in the financial statements as "more-likely-than-not" to be sustained upon examination. The interpretation also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of required disclosures associated with any recorded income tax uncertainties. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption are to be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. FIN 48 is effective for the Company beginning in fiscal year 2007. The Company is evaluating the impact of the adoption of FIN 48, but does not expect FIN 48 to have a material impact on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*." SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under this statement, fair value measurements are required to be separately disclosed, by level, within the fair value hierarchy. SFAS 157 is effective for the Company beginning in fiscal 2008. The Company is currently evaluating the impact of SFAS 157, but does not expect its adoption to have a material impact on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The provisions of SAB 108 were effective for the Company's fiscal year ending December 30, 2006. The adoption of SAB 108 did not have a material impact on the Company's consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Financial instruments that potentially subject us to concentrations of credit risk consist principally of investments. The counterparties to the agreements consist of government agencies and various major corporations of investment grade credit standing. We do not believe we are exposed to significant risk of non-performance by these counterparties because we limit the amount of credit exposure to any one financial institution and any one type of investment.

Changes in the overall level of interest rates affect income generated from our short- and long-term investments in cash, cash equivalents and marketable securities. If overall interest rates were one percentage point lower than current rates, our annual interest income would decline by approximately $0.9 million based on our short- and long-term investments as of December 30, 2006. We do not manage our investment interest-rate volatility risk through the use of derivative instruments.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Shareholders
Select Comfort Corporation:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Select Comfort Corporation maintained effective internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Select Comfort Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Select Comfort Corporation maintained effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Select Comfort Corporation maintained, in all material respects, effective internal

control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Select Comfort Corporation and subsidiaries as of December 30, 2006 and December 31, 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 30, 2006 and our report dated February 26, 2007 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Minneapolis, Minnesota
February 26, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

The Board of Directors and Shareholders
Select Comfort Corporation:

We have audited the accompanying consolidated balance sheets of Select Comfort Corporation and subsidiaries as of December 30, 2006 and December 31, 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 30, 2006. In connection with our audits of the consolidated financial statements, we also have audited financial statement Schedule II – Valuation and Qualifying Accounts. 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Select Comfort Corporation and subsidiaries as of December 30, 2006 and December 31, 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 30, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related 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 described in Notes 1 and 7 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, on January 1, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Select Comfort Corporation's internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 26, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Minneapolis, Minnesota
February 26, 2007

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Consolidated Balance Sheets
December 30, 2006 and December 31, 2005
(in thousands, except per share amounts)

	2006	2005
Assets		
Current assets:		

Cash and cash equivalents	$ 8,819	$ 43,867
Marketable securities – current	37,748	24,122
Accounts receivable, net of allowance for doubtful accounts of $529 and $552, respectively	12,164	6,234
Inventories	24,120	21,982
Prepaid expenses	10,227	9,841
Deferred income taxes	5,785	6,139
Other current assets	4,305	3,875
Total current assets	103,168	116,060
Marketable securities – non-current	43,608	55,102
Property and equipment, net	59,384	53,866
Deferred income taxes	19,275	11,256
Other assets	3,526	3,554
Total assets	$ 228,961	$ 239,838
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 46,061	$ 42,659
Customer prepayments	9,552	14,718
Accruals:		
Sales returns	3,907	5,403
Compensation and benefits	20,057	24,839
Taxes and withholding	5,053	9,624
Other current liabilities	12,901	8,659
Total current liabilities	97,531	105,902
Warranty liabilities	7,769	5,354
Other long-term liabilities	7,967	7,235
Total liabilities	113,267	118,491
Shareholders' equity:		
Undesignated preferred stock; 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, $0.01 par value; 142,500 shares authorized, 51,544 and 53,598 shares issued and outstanding, respectively	515	536
Additional paid-in capital	4,039	56,854
Retained earnings	111,140	63,957
Total shareholders' equity	115,694	121,347
Total liabilities and shareholders' equity	$ 228,961	$ 239,838

See accompanying notes to consolidated financial statements.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Operations
Years ended December 30, 2006, December 31, 2005 and January 1, 2005
(in thousands, except per share amounts)

	2006	2005	2004
Net sales	$ 806,038	$ 689,548	$ 557,639
Cost of sales	315,530	283,072	217,801
Gross profit	490,508	406,476	339,838
Operating expenses:			
Sales and marketing	341,630	286,206	250,628
General and administrative	65,401	49,300	37,826
Research and development	4,687	2,219	1,853
Asset impairment charges	5,980	162	—
Total operating expenses	417,698	337,887	290,307
Operating income	72,810	68,589	49,531
Interest income	3,018	2,174	1,414
Income before income taxes	75,828	70,763	50,945
Income tax expense	28,645	26,996	19,390

Net income	$ 47,183	$ 43,767	$ 31,555
Basic net income per share:			
Net income per share – basic	$ 0.89	$ 0.82	$ 0.58
Weighted-average common shares – basic	52,837	53,357	54,015
Diluted net income per share:			
Net income per share – diluted	$ 0.85	$ 0.76	$ 0.53
Weighted-average common shares – diluted	55,587	57,674	59,525

See accompanying notes to consolidated financial statements.

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SELECT COMFORT CORPORATION
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Consolidated Statements of Shareholders' Equity
Years ended December 30, 2006, December 31, 2005 and January 1, 2005
(in thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings/ (Accumulated Deficit)	Total
	Shares	Amount			
Balance at January 3, 2004	53,655	$ 537	$ 103,029	$ (11,365)	$ 92,201
Exercise of common stock options	1,525	15	4,428	—	4,443
Exercise of common stock warrants	53	1	4	—	5
Tax benefit from equity compensation	—	—	4,641	—	4,641
Repurchases of common stock	(1,707)	(17)	(20,836)	—	(20,853)
Issuances of common stock	216	2	2,350	—	2,352
Net income	—	—	—	31,555	31,555
Balance at January 1, 2005	53,742	538	93,616	20,190	114,344
Exercise of common stock options	1,458	15	6,967	—	6,982
Exercise of common stock warrants	1,772	18	(9)	—	9
Tax benefit from equity compensation	—	—	3,758	—	3,758
Repurchases of common stock	(3,653)	(37)	(49,690)	—	(49,727)
Issuances of common stock	279	2	2,212	—	2,214
Net income	—	—	—	43,767	43,767
Balance at December 31, 2005	53,598	536	56,854	63,957	121,347
Exercise of common stock options	1,544	15	7,495	—	7,510
Exercise of common stock warrants	75	1	—	—	1
Tax benefit from equity compensation	—	—	9,769	—	9,769
Stock-based compensation	—	—	8,325	—	8,325
Repurchases of common stock	(3,889)	(39)	(79,700)	—	(79,739)
Issuances of common stock	216	2	1,296	—	1,298
Net income	—	—	—	47,183	47,183
Balance at December 30, 2006	51,544	$ 515	$ 4,039	$ 111,140	$ 115,694

See accompanying notes to consolidated financial statements.

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SELECT COMFORT CORPORATION
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Consolidated Statements of Cash Flows
Years ended December 30, 2006, December 31, 2005 and January 1, 2005
(in thousands)

	2006	2005	2004
Cash flows from operating activities:			
Net income	$ 47,183	$ 43,767	$ 31,555
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	19,684	15,747	13,643
Stock-based compensation	8,325	793	405
Disposals and impairments of assets	5,912	172	11
Excess tax benefits from stock-based compensation	(8,565)	—	—
Changes in deferred income taxes	(7,665)	(1,353)	(4,032)
Change in operating assets and liabilities:			
Accounts receivable	(5,930)	(397)	(1,042)
Inventories	(2,138)	(1,501)	(6,371)
Prepaid expenses and other assets	(823)	(3,506)	(2,492)
Accounts payable	6,091	5,388	9,765
Customer prepayments	(5,166)	5,350	3,398
Accrued sales returns	(1,496)	365	1,569
Accrued compensation and benefits	(4,782)	10,926	(3,390)
Accrued taxes and withholding	5,198	6,990	7,372
Warranty liabilities	2,574	3,805	(418)
Other accruals and liabilities	974	952	2,509
Net cash provided by operating activities	59,376	87,498	52,482
Cash flows from investing activities:			
Purchases of property and equipment	(31,079)	(25,840)	(21,399)
Investments in marketable securities	(28,072)	(39,172)	(72,540)
Proceeds from maturity of marketable securities	25,940	36,625	46,256
Net cash used in investing activities	(33,211)	(28,387)	(47,683)
Cash flows from financing activities:			
Net (decrease) increase in short-term borrowings	(1,388)	784	10,220
Repurchases of common stock	(77,199)	(49,727)	(20,853)
Proceeds from issuance of common stock	8,809	8,413	6,395
Excess tax benefits from stock-based compensation	8,565	—	—
Net cash used in financing activities	(61,213)	(40,530)	(4,238)
(Decrease) increase in cash and cash equivalents	(35,048)	18,581	561
Cash and cash equivalents, at beginning of year	43,867	25,286	24,725
Cash and cash equivalents, at end of year	$ 8,819	$ 43,867	$ 25,286
Supplemental Disclosure of Cash Flow Information			
Cash paid during the year for income taxes	$ 30,628	$ 22,563	$ 16,842

See accompanying notes to consolidated financial statements.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) Business and Summary of Significant Accounting Policies

Business

Select Comfort Corporation and its wholly-owned subsidiaries (the Company) develops, manufactures and markets premium quality, adjustable-firmness beds and related bedding accessories in the United States and Canada. The Company sells through four distribution channels: Retail, Direct, E-commerce and Wholesale. The percentage of the Company's total net sales from each of our channels during the last three years is as follows:

	2006	2005	2004
Retail	76.2%	76.9%	78.0%
Direct	9.4%	10.8%	11.5%
E-commerce	5.6%	5.0%	4.6%

Wholesale	8.8%	7.3%	5.9%
Total	100.0%	100.0%	100.0%

Financial Statement Presentation

The Company's fiscal year ends on the Saturday closest to December 31. Fiscal years and their respective fiscal year ends are as follows: fiscal year 2006 ended December 30, 2006, fiscal year 2005 ended December 31, 2005 and fiscal year 2004 ended January 1, 2005. Fiscal years 2006, 2005 and 2004 each had 52 weeks.

On May 9, 2006, our Board of Directors approved a three-for-two stock split. Shareholders of record as of May 25, 2006 received one additional share for every two shares owned, with fractional shares being redeemed for cash. The additional shares were distributed on June 8, 2006. All share and per share information herein reflects this stock split.

Principles of Consolidation

The consolidated financial statements include the accounts of Select Comfort Corporation and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less. Outstanding checks in excess of funds on deposit (book overdrafts) totaled $9,616,000 and $11,004,000 at December 30, 2006, and December 31, 2005, respectively. Book overdrafts are included in accounts payable in our consolidated balance sheets and in financing activities in our consolidated statements of cash flows.

Marketable Securities

Marketable Securities include highly liquid investment grade debt instruments issued by the U.S. government and related agencies, municipalities and corporations, and commercial paper issued by companies with investment grade ratings.

These investments have an original maturity of up to 36 months. Investments with an original maturity of greater than 90 days are classified as marketable securities. Marketable securities with a remaining maturity of greater than one year are classified as long-term. Investments are classified as held-to-maturity based on our intent and ability to hold to maturity, and carried at amortized cost.

Inventories

Inventories include material, labor and overhead and are stated at the lower of cost or market. Cost is determined by the first-in, first-out method.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(1) Business and Summary of Significant Accounting Policies – (Continued)

Property and Equipment

Property and equipment, carried at cost, are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of the estimated useful lives of the assets or the contractual term of the lease, with consideration of lease renewal option if renewal appears probable. Estimated useful lives of the Company's property and equipment by major asset category are as follows:

Leasehold improvements	5 to 10 years
Office furniture and equipment	5 to 7 years
Production machinery, computer equipment and software	3 to 7 years

Other Assets

Other assets include security deposits, patents, trademarks and goodwill. Patents and trademarks are amortized using the straight-line method over periods ranging from 10 to 17 years.

Fair Value of Financial Instruments

The carrying value of cash and cash equivalents, accounts receivable, accounts payable and other current assets and liabilities approximate fair value because of their short-term maturity.

Research and Development Costs

Costs incurred in connection with research and development are charged to expense as incurred.

Operating Leases

Rent expense is recognized on a straight-line basis over the lease term, after consideration of rent escalations and rent holidays. The Company records any difference between the straight-line rent amounts and amounts payable under the leases as part of deferred rent, in other accrued liabilities or other long-term liabilities, as appropriate. The lease term for purposes of the calculation is the earlier of the lease commencement date or the date the Company takes possession of the property. Leasehold improvements that are funded by landlord incentives or allowances under an operating lease are recorded as deferred rent and amortized as reductions to rent expense over the lease term.

Pre-opening Costs

Costs associated with the start up and promotion of new store openings are expensed as incurred.

Advertising Costs

The Company incurs advertising costs associated with print and broadcast advertisements. Advertising costs are charged to expense when the ad first runs. Advertising expense was $105,329,000, $89,413,000, and $78,532,000 in 2006, 2005 and 2004, respectively. Advertising costs deferred and included in prepaid expenses in the Company's consolidated balance sheets were $555,000 and $1,133,000 as of December 30, 2006 and December 31, 2005, respectively.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(1) Business and Summary of Significant Accounting Policies – (Continued)

Insurance

The Company is self-insured for certain losses related to health and workers' compensation claims, although it does obtain third-party insurance coverage to limit exposure to these claims. The Company estimates its self-insured liabilities using a number of factors including historical claims experience and an analysis of incurred but not reported claims. The Company's self-insurance liability was $3,385,000 and $3,308,000, at December 30, 2006 and December 31, 2005, respectively, and is included in other current liabilities in our consolidated balance sheets.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123R, "*Share-Based Payment*." SFAS 123R is a revision of FASB Statement No. 123, "*Accounting for Stock-Based Compensation*," and supersedes Accounting Principles Board ("APB") Opinion No. 25, "*Accounting for Stock Issued to Employees*," and amends SFAS No. 95, "*Statement of Cash Flows*," and its related implementation guidance. SFAS 123R focuses primarily on accounting for transactions in which an entity compensates employees through share-based payment transactions. SFAS 123R requires a public entity to measure the cost of employee services received in exchange for the award of equity instruments based on the fair value of the award at the date of grant. The cost is to be recognized over the period during which an employee is required to provide services in exchange for the award, or to their eligible retirement date, if earlier.

SFAS 123R also requires the benefit of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under previous accounting rules. This requirement reduces net operating cash flows and increases net financing cash flows in periods subsequent to adoption. Total cash flows remain unchanged from those reported under previous accounting rules. Effective January 1, 2006, the Company adopted the provisions of SFAS 123R using the modified prospective method. Results of operations for prior annual periods have not been restated to reflect recognition of stock-based compensation expense.

Prior to the adoption of SFAS 123R, the Company followed the intrinsic value method in accordance with APB 25 to account for its employee stock options and employee stock purchase plan. Accordingly, no compensation expense was recognized for share purchase rights granted in connection with the issuance of stock options under the Company's employee stock option plan or employee stock purchase plan; however, compensation expense was recognized in connection with the issuance of restricted share grants. See Note 7 to the Consolidated Financial Statements for additional information on stock-based compensation.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. 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. A valuation allowance is established for any portion of deferred tax assets that are not considered more likely than not to be realized.

Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing net income attributable to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share includes potentially dilutive common shares consisting of stock options, restricted stock and warrants using the treasury stock method.

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(1) Business and Summary of Significant Accounting Policies – (Continued)

Accounting Estimates and Critical Accounting Policies

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Predicting future events is inherently an imprecise activity and as such requires the use of judgment. Critical accounting policies consist of revenue recognition, sales returns, warranty liabilities, asset impairment charges and stock-based compensation.

Revenue Recognition

Revenue is recognized when the sales price is fixed or determinable, collectibility is reasonably assured and title passes. Amounts billed to customers for delivery and set up are included in net sales. Revenue is reported net of estimated sales returns and excludes sales taxes.

Sales Returns

Returns are accepted by the Company up to 30 nights following the sale. The accrued sales returns estimate is based on historical return rates, which are reasonably consistent from period to period and is adjusted for any current trends as appropriate. If actual returns vary from expected rates, sales in future periods are adjusted.

Warranty Liabilities

The Company provides a 20-year limited warranty on its adjustable-firmness beds. The customer participates over the last 18 years of the warranty period by paying a portion of the retail value of replacement parts. Estimated warranty costs are expensed at the time of sale based on historical claims incurred by the Company and are adjusted for any current trends as appropriate. Actual warranty claim costs could differ from these estimates. The Company classifies as noncurrent those estimated warranty costs expected to be paid out in greater than one year. The activity in the accrued warranty liabilities account was as follows (in thousands):

	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions from Reserves	Balance at End of Year
2006	$ 7,649	$ 13,521	$ 10,947	$ 10,223
2005	3,844	12,536	8,731	7,649
2004	4,262	7,839	8,257	3,844

The increases in warranty liabilities reflects higher sales volume, increased claim rates and a correction in warranty accruals in 2006 to include freight costs which had not been included in prior periods. This correction was immaterial to current and prior periods.

Asset Impairment Charges

The Company reviews its long-lived assets and identifiable intangibles 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 undiscounted cash flows expected to be generated by the asset plus net proceeds expected from disposition of the asset (if any). When an impairment loss is recognized, the carrying amount of the asset is reduced to estimated fair value based on discounted cash flows, quoted market prices or other valuation techniques. Assets to be disposed of are reported at the lower of the carrying amount of the asset or fair value less costs to sell. The Company reviews store assets for potential impairment based on historical cash flows, lease termination provisions and expected future store operating results.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(1) Business and Summary of Significant Accounting Policies – (Continued)

The test for goodwill impairment is a two-step process, and is performed at least annually. The first step is a comparison of the fair value of the reporting unit with its carrying amount, including goodwill. If this step reflects impairment, then the loss would be measured as the excess of recorded goodwill over its implied fair value. Implied fair value is the excess of fair value of the reporting unit over the fair value of all identified assets and liabilities. Fair value is determined utilizing widely accepted valuation techniques, including discounted cash flows. The carrying value of goodwill as of December 30, 2006 and December 31, 2005 was $2,850,000.

Stock-Based Compensation

Effective January 1, 2006, the Company changed its accounting for stock options in accordance with SFAS 123R to the fair value method and now recognizes stock option compensation expense in the consolidated financial statements. The valuation of stock options and resulting compensation expense is determined using the Black-Scholes-Merton option-pricing model with the most significant inputs into the model being exercise price, our estimate of expected stock price volatility and the weighted average expected life of the options. Previously, two alternative methods existed for accounting for stock options: the intrinsic value method and the fair value method. Prior to fiscal 2006, we used the intrinsic value method of accounting for stock options and accordingly, no compensation expense was recognized in the financial statements for options granted to employees, or for the discount feature of our employee stock purchase plan. This change in accounting policy had a material impact on our consolidated results of operations and net income per share.

Sources of Supply

The Company currently obtains materials and components used to produce its beds from outside sources. As a result, the Company is dependent upon suppliers that in some instances, are the Company's sole source of supply. The Company is continuing its efforts to dual-source key components. The failure of one or more of the Company's suppliers to provide it with materials or components on a timely basis could significantly impact our consolidated results of operations and net income per share.

Reclassifications

At the end of fiscal 2006, the Company reclassified certain prior-year amounts to conform to the current-year presentation. The significant reclassifications were as follows:

- Certain sales incentives and customer advertising allowances were reclassified as reductions of net sales (previously recorded as sales and marketing expenses). The impact of these reclassifications were a decrease to net sales of $1,518,000 in 2005.
- Incentive compensation expenses were reclassified as increases to cost of sales or sales and marketing expense (previously recorded as general and administrative expenses). The impact of these reclassifications were increases to cost of sales of $2,482,000 and $836,000 in 2005 and 2004, respectively; and increases to sales and marketing expenses of $441,000 in 2005 and decreases to sales and marketing expenses of $237,000 in 2004.
- Consumer and clinical research expenses were reclassified as increases to sales and marketing expense (previously recorded as general and administrative expenses). The impact of these reclassifications were increases to sales and marketing expenses of $1,230,000 and $940,000 in 2005 and 2004, respectively.
- Book overdrafts of $11,004,000 were reclassified from cash to accounts payable on the December 31, 2005 consolidated statement of financial position. As a result of the change in balance sheet classification, $784,000 and $10,220,000 in 2005 and 2004, respectively, were reclassified from cash and cash equivalents to cash flows from financing activities.

These reclassifications were considered immaterial and had no effect on previously reported net income, retained earnings or operating cash flows.

SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(1) Business and Summary of Significant Accounting Policies – (Continued)

New Accounting Pronouncements

In May 2005, the FASB issued Statement of Financial Accounting Standard's ("SFAS") No. 154, "*Accounting Changes and Error Corrections*," which supersedes Accounting Principles Board ("APB") Opinion No. 20, "*Accounting Changes*," and FASB Statement No. 3, "*Reporting Accounting Changes in Interim Financial Statements*." SFAS 154 requires retrospective application of changes in accounting principles to prior period financial statements as of the earliest date practicable. This statement also redefines "restatement" as the revising of previously issued financial statements to reflect the correction of an error. The provisions of SFAS 154 were effective for the Company in fiscal year 2006. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "*Accounting for Uncertainty in Income Taxes*." FIN 48 defines the threshold for recognizing the benefits of tax positions in the financial statements as "more-likely-than-not" to be sustained upon examination. The interpretation also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of required disclosures associated with any recorded income tax uncertainties. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption are to be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. FIN 48 is effective for the Company beginning in fiscal year 2007. The Company is evaluating the impact of the adoption of FIN 48, but does not expect FIN 48 to have a material impact on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*." SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under this statement, fair value measurements are required to be separately disclosed, by level, within the fair value hierarchy. SFAS 157 is effective for the Company beginning in fiscal 2008. The Company is currently evaluating the impact of SFAS 157, but does not expect its adoption to have a material impact on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects

of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The provisions of SAB 108 were effective for the Company's fiscal year ending December 30, 2006. The adoption of SAB 108 did not have a material impact on the Company's consolidated financial statements.

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SELECT COMFORT CORPORATION
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Notes to Consolidated Financial Statements – (Continued)

(2) Marketable Securities

Marketable securities are summarized as follows (in thousands):

December 30, 2006	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government agencies	$ 5,998	$ —	$ (23)	$ 5,975
Municipal securities	75,358	—	(279)	75,079
	$ 81,356	$ —	$ (302)	$ 81,054

December 31, 2005	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Corporate securities	$ 3,442	$ —	$ (23)	$ 3,419
U.S. government agencies	19,075	—	(287)	18,788
Municipal securities	56,707	1	(358)	56,350
	$ 79,224	$ 1	$ (668)	$ 78,557

As of December 30, 2006, the contractual maturities were as follows (in thousands):

	Amortized Cost	**Fair Value**
0 – 12 Months	$ 37,748	$ 37,645
13 – 24 Months	34,422	34,237
25 – 36 Months	9,186	9,172
Total	$ 81,356	$ 81,054

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SELECT COMFORT CORPORATION
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Notes to Consolidated Financial Statements – (Continued)

(3) Inventories

Inventories consist of the following (in thousands):

	December 30, 2006	**December 31, 2005**
Raw materials	$ 6,576	$ 6,549
Work in progress	111	226
Finished goods	17,433	15,207
	$ 24,120	$ 21,982

The Company's finished goods inventory, as of December 30, 2006, was comprised of $8,241,000 of finished beds, including retail display beds and deliveries in-transit to those customers who have utilized home delivery services, $4,141,000 of finished components that were ready for assembly for the completion of beds, and $5,051,000 of retail accessories.

The Company's finished goods inventory, as of December 31, 2005, was comprised of $4,183,000 of finished beds, including retail display beds and deliveries in-transit to those customers who have utilized home delivery services, $7,148,000 of finished components that were ready for assembly for the completion of beds, and $3,876,000 of retail accessories.

(4) Property and Equipment

Property and equipment consist of the following (in thousands):

	December 30, 2006	December 31, 2005
Leasehold improvements	$ 77,209	$ 63,536
Office furniture and equipment	3,693	3,580
Production machinery, computer equipment and software	64,814	57,616
Less: Accumulated depreciation and amortization	(86,332)	(70,866)
	$ 59,384	$ 53,866

During fiscal years 2006 and 2005, the Company recorded asset impairment charges of $5,980,000 and $162,000, respectively. The Company's 2006 asset impairment charges were comprised of $5,371,000 resulting from the abandonment of software it had been developing and $609,000 resulting from the difference between the fair value and net book value of impaired store assets. During 2006, the Company abandoned certain internal use software it had been developing and committed to a plan to implement SAP® as its new enterprise resource planning system with an expected implementation in the first half of 2008. The Company's 2005 asset impairment charges of $162,000 were related to impaired store assets.

(5) Leases

The Company rents office and manufacturing space under seven operating leases which, in addition to the minimum lease payments, require payment of a proportionate share of the real estate taxes and certain building operating expenses. The Company also rents retail space under operating leases which, in addition to the minimum lease payments, require payment of contingent rents based upon sales levels and require payment of a proportionate share of the real estate taxes and certain building operating expenses.

Lease payments that depend on factors that are not measurable at the inception of the lease, such as future sales levels, are contingent rents and are excluded from minimum lease payments and included in the determination of total rent expense when it is probable the expense has been incurred and the amount is reasonably estimable. Future payments for real estate taxes and certain building operating expenses for which the Company is obligated are not included in minimum lease payments.

The Company also leases delivery trucks associated with its home delivery service, which in addition to the minimum lease payments, require payment of a management fee and contain certain residual value guarantee provisions that would become due at the expiration of the operating agreement if the fair value of the leased vehicles is less than the guaranteed residual value. The guaranteed residual value at lease expiration is approximately $1,269,000. We believe the likelihood of funding the guarantee obligation under any provision of the operating lease is remote. Rent expense was as follows (in thousands):

	2006	2005	2004
Minimum rents	$ 27,579	$ 23,619	$ 20,050
Contingent rents	9,443	8,246	6,112
Total	$ 37,022	$ 31,865	$ 26,162
Equipment rents	$ 1,042	$ 1,927	$ 2,056

The aggregate minimum rental commitments under operating leases for subsequent years are as follows (in thousands):

2007	$ 28,429
2008	28,740
2009	25,187
2010	21,804
2011	16,215
Thereafter	34,929
	$ 155,304

(6) Credit Agreement

In June 2006, the Company entered into a five-year Syndicated Credit Agreement (the "Credit Agreement"). The Credit Agreement provides for a $100 million senior unsecured revolving credit facility available to be used by the Company for general corporate purposes. Borrowings available under the credit facility can be increased by an additional amount up to $75 million.

Borrowings under the credit facility bear interest at a floating rate and may be maintained as base rate loans (tied to the prime rate or the federal funds rate plus 0.5%) or as Eurocurrency rate loans tied to LIBOR, plus a margin up to 1.0% depending on our leverage ratio, as defined. The Company is subject to certain financial covenants under the agreement principally consisting of maximum leverage and minimum interest coverage ratios. The Company was in full compliance with all covenants as of December 30, 2006. The Company had no borrowings against the credit facility as of December 30, 2006.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(7) Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R ("SFAS 123R"), "*Share-Based Payment*," which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS 123R supersedes the Company's previous accounting methodology using the intrinsic value method under Accounting Principles Board Opinion No. 25 ("APB 25"), "*Accounting for Stock Issued to Employees*." Under the intrinsic value method, no share-based compensation expense related to stock option awards granted to employees had been recognized in the Company's Consolidated Statements of Operations, since all stock option awards granted under the plans had an exercise price equal to or greater than the market value of the common stock on the date of the grant.

The Company adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation expense recognized during the year ended December 30, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified prospective transition method, the consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123R.

Current Period Impact of Adopting SFAS 123R

The following table shows the impact of adopting SFAS 123R on selected reported items ("As Reported") as compared with previous reporting permitted by APB 25 ("Pro Forma"):

	Year Ended December 30, 2006		
(in thousands, except per share amounts)	As Reported	Pro Forma	Increase (Decrease)
Operating income	$ 72,810	$ 79,422	$ (6,612)
Income before income taxes	75,828	82,440	(6,612)
Net income	47,183	51,806	(4,623)
Net cash provided by (used in):			
Operating activities	59,376	67,941	(8,565)
Financing activities	(61,213)	(69,778)	8,565
Net income per share:			
Basic	$ 0.89	$ 0.98	$ (0.09)
Diluted	0.85	0.93	(0.08)

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(7) Stock-Based Compensation – (Continued)

Prior Period Pro Forma

Results of operations for fiscal year 2005 and prior periods have not been restated to reflect recognition of stock-based compensation expense. If compensation expense for employee stock-based compensation had been determined based on the fair value at the grant dates consistent with the methods provided in SFAS 123, the Company's net income and net income per share for the years ended December 31, 2005 and January 1, 2005 would have been as follows (in thousands, except per share amounts):

	2005	2004
Net income, as reported	$ 43,767	$ 31,555
Stock-based compensation cost, net of tax, included in net income	490	251
Stock-based compensation cost, net of tax, if fair value method had been applied	(4,392)	(4,498)
Net income, pro forma	$ 39,865	$ 27,308
Net income per share:		
Basic – as reported	$ 0.82	$ 0.58
Basic – pro forma	0.75	0.51
Diluted – as reported	$ 0.76	$ 0.53
Diluted – pro forma	0.69	0.46

Stock-Based Compensation Plans

The Company compensates officers, directors and key employees with stock-based compensation under three stock plans approved by the Company's shareholders in 1990, 1997 and 2004 and administered under the supervision of the Company's Board of Directors. At December 30, 2006, a total of 1,964,000 shares were available for future grant under the stock plans. Stock option awards are granted at exercise prices equal to the average of the high and low prices of the Company's stock on the date of grant. Generally, options vest proportionally over periods of three to four years from the dates of the grant and expire after ten years. Compensation expense is recognized ratably over the vesting period.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(7) Stock-Based Compensation – (Continued)

A summary of the Company's stock option activity for each of the years in the three-year period ended December 30, 2006, is as follows (in thousands, except per share amounts):

	Stock Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value *
Outstanding at January 3, 2004	7,506	$ 4.34		
Granted	890	16.18		
Exercised	(1,526)	2.93		
Canceled	(119)	10.19		
Outstanding at January 1, 2005	6,751	6.12		
Granted	954	13.68		
Exercised	(1,459)	4.79		
Canceled	(179)	13.32		
Outstanding at December 31, 2005	6,067	7.42		
Granted	1,143	24.44		
Exercised	(1,544)	4.87		
Canceled	(127)	16.48		
Outstanding at December 30, 2006	5,539	$ 11.43	6.13	$ 33,952
Exercisable at December 30, 2006	3,689	$ 6.98	4.86	$ 39,051

**** Aggregate intrinsic value includes only those options where the exercise price is equal to or greater than the share price on the date of grant.***

The following table summarizes information about options outstanding at December 30, 2006 (in thousands, except per share amounts):

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices	Shares	Weighted-Average Remaining	Weighted-Average	Shares	Weighted-Average

		Contractual Term (years)	Exercise Price		Exercise Price
$ 0.36 – $ 2.45	914	4.72	$ 1.51	914	$ 1.51
2.46 – 4.55	1,009	3.32	3.87	1,009	3.87
4.56 – 12.70	1,114	5.25	8.82	1,008	8.45
12.71 – 16.60	1,320	7.54	14.99	687	15.54
16.61 – 26.95	1,182	8.88	24.05	71	17.81
	5,539	6.13	11.43	3,689	6.98

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(7) Stock-Based Compensation – (Continued)

Other information pertaining to options for the years ended December 30, 2006, December 31, 2005, and January 1, 2005 is as follows (in thousands, except per share amounts):

	2006	2005	2004
Weighted-average grant date fair value of stock options granted	$ 12.69	$ 7.46	$ 6.79
Total intrinsic value (at exercise) of stock options exercised	$ 28,507	$ 14,020	$ 20,254
Cash received from the exercise of stock options	$ 8,809	$ 8,413	$ 6,395
Stock-based compensation expense recognized in the consolidated statements of operations	$ 8,325	$ 793	$ 405
Excess income tax benefits from exercise of stock options	$ 8,565	$ 3,758	$ 4,641

At December 30, 2006, there was $13.9 million of total stock option compensation expense related to non-vested awards not yet recognized, which is expected to be recognized over a weighted-average period of 3.3 years.

Determining Fair Value

We estimate the fair value of stock options granted using the Black-Scholes-Merton option-pricing model and a single option award approach. A description of significant assumptions used to estimate term, volatility and risk-free interest rate follows:

Expected Term – Expected term represents the period that our stock-based awards are expected to be outstanding and was determined based on historical experience and anticipated future exercise patterns, giving consideration to the contractual terms of unexercised stock-based awards.

Expected Volatility – Expected volatility is determined based on implied volatility of our traded options and historical volatility of our stock price.

Risk-Free Interest Rate – The risk-free interest rate is based on the implied yield currently available on U.S. Treasury zero-coupon issues with a term equal to the expected term.

The assumptions used to calculate the fair value of awards granted during 2006, 2005, and 2004 using the Black-Scholes-Merton option-pricing model were as follows:

	2006	2005	2004
Expected dividend yield	0%	0%	0%
Expected volatility	50%	60%	55%
Risk-free interest rate	4.7%	4.0%	2.0%
Expected term (in years)	5.6	5.0	3.6

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(7) Stock-Based Compensation – (Continued)

Restricted and Performance Stock

The Company issues restricted and performance stock awards to certain employees in conjunction with its share-based compensation plan. The awards cliff-vest at four, five or ten years of service based on continued employment. Compensation expense related to stock awards is determined on the grant-date based on the publicly quoted fair market value of the Company's common stock and is charged to earnings on a straight-line basis over the vesting period. Performance stock may be earned and become vested in a specific percentage depending upon the extent to which the target performance is met as of the last day of the performance cycle. Total compensation expense related to restricted and performance stock was $1,713,000, $794,000, and $405,000 for the years ended December 30, 2006, December 31, 2005, and January 1, 2005, respectively. All outstanding restricted and performance stock awards were unvested at December 30, 2006, December 31, 2005, and January 1, 2005. Restricted and performance stock activity was as follows for the years ended December 30, 2006, December 31, 2005, and January 1, 2005 (in thousands, except per share amounts):

	Restricted Stock	Weighted-Average Grant Date Fair Value	Performance Stock	Weighted-Average Grant Date Fair Value
Outstanding at January 3, 2004	153	$ 6.23	—	$ —
Granted	77	16.57	—	—
Canceled	—	—	—	—
Outstanding at January 1, 2005	230	9.70	—	—
Granted	142	13.48	69	18.15
Canceled	(54)	7.28	(1)	13.49
Outstanding at December 31, 2005	318	11.78	68	18.23
Granted	128	23.46	89	24.65
Canceled	(51)	16.89	(9)	20.86
Outstanding at December 30, 2006	395	$ 14.90	148	$ 21.93

At December 30, 2006, there was $6.1 million of unrecognized compensation expense related to non-vested restricted and performance share awards, which is expected to be recognized over a weighted-average period of 3.0 years.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(8) Income Taxes

The (provision) benefit for income taxes consists of the following (in thousands):

	2006	2005	2004
Current:			
Federal	$ (30,572)	$ (23,785)	$ (20,494)
State	(5,738)	(4,564)	(2,928)
	(36,310)	(28,349)	(23,422)
Deferred:			
Federal	6,387	1,047	3,679
State	1,278	306	353
	7,665	1,353	4,032
Income tax expense	$ (28,645)	$ (26,996)	$ (19,390)

Effective tax rates differ from statutory federal income tax rates as follows:

	2006	2005	2004
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.8	3.9	3.1
Other	(1.0)	(0.8)	(0.0)
	37.8%	38.1%	38.1%

The tax effects of temporary differences that give rise to deferred income taxes were as follows (in thousands):

	2006	2005
Deferred tax assets:		
Current:		
Warranty and returns liabilities	$ 2,481	$ 3,268

Accrued compensation and benefits	2,965	2,713
Other	339	374
Long-term:		
Net operating and capital loss carryforwards	61	797
Depreciation	10,159	6,010
Deferred rent and lease incentives	3,107	2,807
Warranty reserve	3,030	1,797
Other	2,918	289
Total gross deferred tax assets	25,060	18,055
Valuation allowance	—	(660)
Total net deferred tax assets	$ 25,060	$ 17,395

At December 30, 2006, the Company had net operating loss carryforwards for state income tax purposes of $1,153,000 which will expire between 2014 and 2025.

The Company believes that it is more likely than not that it will generate sufficient taxable income to utilize its deferred tax assets, including net operating loss carryforwards, within any applicable carryover periods.

The Company's $660,000 valuation allowance at December 31, 2005 related to a capital loss carryforward that expired unutilized during 2006.

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SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(9) Net Income per Common Share

The following computations reconcile net income per share – basic with net income per share – diluted (in thousands, except per share amounts):

	2006	2005	2004
Net income	$ 47,183	$ 43,767	$ 31,555
Reconciliation of weighted-average shares outstanding:			
Basic weighted-average shares outstanding	52,837	53,357	54,015
Effect of dilutive securities:			
Options	2,529	2,521	3,279
Warrants	28	1,497	2,009
Restricted shares	193	299	222
Diluted weighted-average shares outstanding	55,587	57,674	59,525
Net income per share – basic	$ 0.89	$ 0.82	$ 0.58
Net income per share – diluted	0.85	0.76	0.53

Additional potentially dilutive securities totaling 1,077,000, 974,000 and 945,000 for the years 2006, 2005 and 2004 have been excluded from diluted EPS because these securities' exercise prices were greater than the average market price of the Company's common shares.

(10) Employee Benefit Plans

Profit Sharing and 401(k) Plan

Under the Company's profit sharing and 401(k) plan, eligible employees may defer up to 50% of their compensation on a pre-tax basis, subject to Internal Revenue Service limitations. Each year, the Company may make a discretionary contribution equal to a percentage of the employee's contribution. During 2006, 2005 and 2004, the Company's contributions, net of forfeitures, were $2,546,000, $2,169,000, and $1,828,000, respectively. During 2004, the Company issued 16,838 shares for a portion of its discretionary contribution.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan which permits employees to purchase Company common stock at a discount based on the average price of the stock on the last business day of the offering period (calendar quarter basis). Purchases are funded by employee payroll deductions during the offering period. The Company reduced the discount from 15% to 5% effective beginning with the third quarter of 2005. Employees purchased 60,464 shares in 2006, 123,416 shares in 2005 and 121,244 shares in 2004 under this plan.

SELECT COMFORT CORPORATION
AND SUBSIDIARIES

Notes to Consolidated Financial Statements – (Continued)

(11) Commitments and Contingencies

The Company is involved in various legal proceedings arising in the ordinary course of business. In the opinion of management, any losses that may occur from these matters are adequately covered by insurance or are provided for in the consolidated financial statements if the liability is probable and estimable in accordance with generally accepted accounting principles. The ultimate outcome of these matters are not expected to have a material effect on the consolidated results of operations or financial position.

Consumer Credit Arrangements

The Company refers customers seeking extended financing to certain third party financiers (Card Servicers). The Card Servicers, if credit is granted, establish the interest rates, fees, and all other terms and conditions of the customer accounts based on their evaluation of the creditworthiness of the customers. As the receivables are owned by the Card Servicers, at no time are the receivables purchased or acquired from the Company. The Company is not liable to Card Servicers for its customers credit defaults. In connection with customer purchases financed under these arrangements, the Card Servicers pay the Company an amount equal to the total amount of such purchases, net of promotional related discounts. The amounts financed and uncollected from Card Servicers under the program were included in accounts receivable and totaled $2,563,000 and $1,610,000 as of December 30, 2006 and December 31, 2005, respectively.

Termination of the Company's agreements with Card Servicers, any material change to the terms of agreements with Card Servicers or in the availability or terms of credit for the Company's customers from Card Servicers, or any delay in securing replacement credit sources, could materially affect the results of the Company's operations and financial condition.

Purchase Commitments

As of December 30, 2006, the Company had $325,000,000 of inventory purchase commitments with its suppliers as part of the normal course of business. There are a limited number of supply contracts that contain penalty provisions for failure to purchase contracted quantities. The Company does not expect potential payments under these provisions to materially affect its results of operations or financial condition.

(12) Summary of Quarterly Financial Data (unaudited)

The following is a condensed summary of actual quarterly results for 2006 and 2005 (in thousands, except per share amounts):

2006	**December**	**September**	**June**	**March**
Net sales	$ 198,013	$ 207,661	$ 188,086	$ 212,278
Gross profit	120,683	128,661	113,642	127,522
Operating income	16,137	21,906	16,462	18,305
Net income	10,767	13,941	10,741	11,734
Net income per share – diluted	0.20	0.25	0.19	0.21

2005	**December**	**September**	**June**	**March**
Net sales	$ 187,497	$ 175,570	$ 154,144	$ 172,337
Gross profit	112,960	103,856	88,538	101,122
Operating income	24,625	18,135	12,181	13,648
Net income	15,817	11,446	7,862	8,642
Net income per share – diluted	0.28	0.20	0.13	0.15

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the company's management, including its principal executive officer and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this annual report. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Management's Report on Internal Control Over Financial Reporting

Select Comfort's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

Select Comfort's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation under these criteria, management concluded that our internal control over financial reporting was effective as of December 30, 2006. Management's assessment of the effectiveness of our internal control over financial reporting as of December 30, 2006 has been audited by KPMG LLP, an independent registered public accounting firm, as stated by their report which is included in Item 8 of this report.

There were no changes in the Company's internal control over financial reporting during the quarter ended December 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information under the captions "Election of Directors," "Corporate Governance at Select Comfort" and "Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement for our 2007 Annual Meeting of Shareholders is incorporated herein by reference. Information concerning our executive officers is included in Part I of this report under the caption "Executive Officers of the Registrant."

We have adopted a Code of Business Conduct applicable to our directors, officers and employees (including our principal executive officer, principal financial officer, principal accounting officer and controller). The Code of Business Conduct is available on the Investor Relations section of our Web site at *http://www.selectcomfort.com*. In the event that we amend or waive any of the provisions of the Code of Business Conduct applicable to our principal executive officer, principal financial officer, principal accounting officer and controller, we intend to disclose the same on our Web site at *http://www.selectcomfort.com*.

ITEM 11. EXECUTIVE COMPENSATION

The information under the captions "Election of Directors – Director Compensation" and "Executive Compensation" in our Proxy Statement for our 2007 Annual Meeting of Shareholders is incorporated herein by reference.

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

The information under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Executive Compensation – Equity Compensation Plan Information" in our Proxy Statement for our 2007 Annual Meeting of Shareholders is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information under the caption "Certain Transactions" in our Proxy Statement for our 2007 Annual Meeting of Shareholders is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information under the caption "Approval of Selection of Independent Auditors" in our Proxy Statement for our 2007 Annual Meeting of Shareholders is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Consolidated Financial Statements and Schedule

(1) Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Shareholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements and Financial Statement Schedule

(2) Consolidated Financial Statement Schedule

The following Report and financial statement schedule are included in this Part IV.

Schedule II – Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

(3) Exhibits

The exhibits to this Report are listed in the Exhibit Index below.

We will furnish a copy of any of the exhibits referred to above at a reasonable cost to any shareholder upon receipt of a written request. Requests should be sent to: Select Comfort Corporation, Investor Relations Department, 6105 Trenton Lane North, Minneapolis, Minnesota 55442.

The following is a list of each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Annual Report on Form 10-K pursuant to Item 15(c):

1. Select Comfort Corporation 1990 Omnibus Stock Option Plan, as amended and restated
2. Select Comfort Corporation 1997 Stock Incentive Plan, as amended and restated
3. Form of Incentive Stock Option Agreement under the 1990 and 1997 Stock Plans
4. Form of Performance Based Stock Option Agreement under the 1990 and 1997 Stock Plans
5. Select Comfort Corporation 2004 Stock Incentive Plan (Amended and Restated as of January 1, 2007)
6. Form of Stock Option Award Agreement under the 2004 Stock Incentive Plan
7. Form of Restricted Stock Award Agreement under the 2004 Stock Incentive Plan
8. Form of Performance Stock Award Agreement under the 2004 Stock Incentive Plan

9. Form of Stock Option Award Agreement (Subject to Performance Adjustment) under the 2004 Stock Incentive Plan
10. Select Comfort Corporation 1999 Employee Stock Purchase Plan, as amended and restated
11. Select Comfort Profit Sharing and 401(K) Plan – 2007 Restatement
12. Select Comfort Executive Investment Plan
13. Select Comfort Executive and Key Employee Incentive Plan
14. Employment Letter from the Company to William R. McLaughlin dated March 3, 2000
15. Employment Letter from the Company to William R. McLaughlin dated March 2, 2006

16. Employment Letter from the Company to J. Douglas Collier dated June 7, 2005

17. Employment Letter from the Company to Mark A. Kimball dated April 22, 1999

18. Employment Letter from the Company to Ernie Park dated May 9, 2006

19. Employment Letter from the Company to Scott F. Peterson dated July 23, 2003

20. Employment Letter from the Company to Kathryn V. Roedel dated March 8, 2005

21. Employment Letter from the Company to Wendy L. Schoppert dated March 15, 2005

22. Employment Letter from the Company to Keith C. Spurgeon dated February 1, 2002

23. Summary of Executive Health Program

24. Summary of Executive Tax and Financial Planning Program

25. Select Comfort Corporation Executive Severance Pay Plan

26. Summary of Non-Employee Director Compensation

27. Amended and Restated Select Comfort Corporation Non-Employee Director Equity Plan

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SIGNATURES

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

SELECT COMFORT CORPORATION
(Registrant)

Dated: February 27, 2007

By: /s/ William R. McLaughlin
William R. McLaughlin
Chairman and Chief Executive Officer
(principal executive officer)

By: /s/ James C. Raabe
James C. Raabe
Chief Financial Officer
(principal financial and accounting officer)

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POWER OF ATTORNEY

Know all persons by these presents, that each person whose signature appears below constitutes and appoints William R. McLaughlin, James C. Raabe and Mark A. Kimball, and each of them, as such person's true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for such person and in such person's name, place and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as such person might or could do in person, hereby ratifying and confirming that all said attorneys-in-fact and agents, or any of them or their or such person's substitute or substitutes, may lawfully do or cause to be done by virtue thereof.

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 date or dates indicated.

NAME	TITLE	DATE
/s/ William R. McLaughlin William R. McLaughlin	Chairman of the Board	February 27, 2007
/s/ Thomas J. Albani Thomas J. Albani	Director	February 26, 2007
/s/ Christine M. Day Christine M. Day	Director	February 24, 2007
/s/ Stephen L. Gulis, Jr. Stephen L. Gulis, Jr.	Director	February 22, 2007
/s/ Christopher P. Kirchen Christopher P. Kirchen	Director	February 22, 2007
/s/ David T. Kollat David T. Kollat	Director	February 23, 2007
/s/ Brenda J. Lauderback Brenda J. Lauderback	Director	February 22, 2007
/s/ Michael A. Peel Michael A. Peel	Director	February 23, 2007
/s/ Ervin R. Shames Ervin R. Shames	Director	February 23, 2007
/s/ Jean-Michel Valette Jean-Michel Valette	Director	February 22, 2007

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SELECT COMFORT CORPORATION
EXHIBIT INDEX TO ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 30, 2006

Exhibit No.	Description	Method Of Filing
3.1	Third Restated Articles of Incorporation of the Company, as amended	Incorporated by reference to Exhibit 3.1 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended January 1, 2000 (File No. 0-25121)
3.2	Articles of Amendment to Third Restated Articles of Incorporation of the Company	Incorporated by reference to Exhibit 3.1 contained in Select Comfort's Current Report on Form 8-K filed May 16, 2006 (File No. 0-25121)
3.3	Restated Bylaws of the Company	Incorporated by reference to Exhibit 3.2 contained in the Select Comfort's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.1	Net Lease Agreement dated December 3, 1993 between the Company and Opus Corporation	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.2	Amendment of Lease dated August 10, 1994 between the Company and Opus Corporation	Incorporated by reference to Exhibit 10.2 contained in the Select Comfort's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.3	Second Amendment to Lease dated May 10, 1995 between the Company and Rushmore Plaza Partners Limited Partnership (successor to Opus Corporation)	Incorporated by reference to Exhibit 10.3 contained in Select Comfort's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.4	Letter Agreement dated as of October 5, 1995 between the Company and Rushmore Plaza Partners Limited Partnership	Incorporated by reference to Exhibit 10.4 contained in Select Comfort's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.5	Third Amendment of Lease, Assignment and Assumption of Lease and Consent dated as of January 1, 1996 among the Company, Rushmore	Incorporated by reference to Exhibit 10.5 contained in Select Comfort's Registration Statement on Form S-1, as amended

	Plaza Partners Limited Partnership and Select Comfort Direct Corporation	(Reg. No. 333-62793)
10.6	Fourth Amendment to Lease dated June 30, 2003 between Cabot Industrial Properties, L.P. (successor to Rushmore Plaza Partners Limited Partnership) and Select Comfort Direct Corporation	Incorporated by reference to Exhibit 10.6 contained in Select Comfort's Annual report on Form 10-K for the fiscal year ended January 3, 2004 (File No. 0-25121)
10.7	Fifth Amendment to Lease dated August 28, 2006 between Cabot Industrial Properties, L.P. (successor to Rushmore Plaza Partners Limited Partnership) and Select Comfort Direct Corporation	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly report on Form 10-Q for the quarter ended September 30, 2006 (File No. 0-25121)

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Exhibit No.	Description	Method Of Filing
10.8	Lease Agreement dated as of September 19, 2002 between the Company and Blind John, LLC (as successor to Frastacky (US) Properties Limited Partnership)	Incorporated by reference to Exhibit 10.6 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 28, 2002 (File No. 0-25121)
10.9	Lease Agreement dated September 30, 1998 between the Company and ProLogis Development Services Incorporated	Incorporated by reference to Exhibit 10.12 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 28, 2002 (File No. 0-25121)
10.10	Net Lease Agreement (Build-to-Suit) by and between Opus Northwest LLC, as Landlord, and Select Comfort Corporation, as Tenant, dated July 26, 2006	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly report on Form 10-Q for the quarter ended July 1, 2006 (File No. 0-25121)
10.11	Profit Participation Agreement by and between Opus Northwest LLC and Select Comfort Corporation dated July 26, 2006	Incorporated by reference to Exhibit 10.2 contained in Select Comfort's Quarterly report on Form 10-Q for the quarter ended July 1, 2006 (File No. 0-25121)
10.12	Select Comfort Corporation 1990 Omnibus Stock Option Plan, as amended and restated	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly Report on Form 10-Q for the quarter ended October 2, 1999 (File No. 0-25121)
10.13	Select Comfort Corporation 1997 Stock Inventive Plan, as amended and restated	Incorporated by reference to Exhibit 10.8 contained in Select Comfort's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 0-25121)
10.14	Form of Incentive Stock Option Agreement under the 1990 and 1997 Stock Plans	Incorporated by reference to Exhibit 10.16 contained in the Company's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.15	Form of Performance Based Stock Option Agreement under the 1990 and 1997 Stock Plans	Incorporated by reference to Exhibit 10.17 contained in Select Comfort's Registration Statement on Form S-1, as amended (Reg. No. 333-62793)
10.16	Select Comfort Corporation 2004 Stock Incentive Plan (Amended and Restated as of January 1, 2007)	Filed herewith
10.17	Form of Stock Option Award Agreement under the Select Comfort Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.28 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)

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Exhibit No.	Description	Method Of Filing
10.18	Form of Restricted Stock Award Agreement under the Select Comfort Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.29 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.19	Form of Performance Stock Award Agreement under the Select Comfort Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.30 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year

		ended December 31, 2005 (File No. 0-25121)
10.20	Form of Stock Option Award Agreement (Subject to Performance Adjustment) under the Select Comfort Corporation 2004 Stock Incentive Plan	Filed herewith
10.21	Select Comfort Corporation 1999 Employee Stock Purchase Plan, as Amended	Incorporated by reference to Exhibit 10.12 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.22	Select Comfort Profit Sharing and 401(K) Plan – 2007 Restatement	Filed herewith
10.23	Select Comfort Executive Investment Plan	Incorporated by reference to Exhibit 10.29 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 28, 2002 (File No. 0-25121)
10.24	Select Comfort Executive and Key Employee Incentive Plan	Incorporated by reference to Exhibit 10.22 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 30, 2000 (File No. 0-25121)
10.25	Employment Letter from the Company to William R. McLaughlin dated March 3, 2000	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly Report on Form 10-Q for the quarter ended April 1, 2000 (File No. 0-25121)
10.26	Employment Letter from the Company to William R. McLaughlin dated March 2, 2006	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed March 6, 2006 (File No. 0-25121)
10.27	Employment Letter from the Company to J. Douglas Collier dated June 7, 2005	Incorporated by reference to Exhibit 10.22 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)

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Exhibit No.	Description	Method Of Filing
10.28	Employment Letter from the Company to Mark A. Kimball dated April 22, 1999	Incorporated by reference to Exhibit 10.25 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended January 1, 2000 (File No. 0-25121)
10.29	Employment Letter from the Company to Ernie Park dated May 9, 2006	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed May 15, 2006 (File No. 0-25121)
10.30	Employment Letter from the Company to Scott F. Peterson dated July 23, 2003	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003 (File No. 0-25121)
10.31	Employment Letter from the Company to Kathryn V. Roedel dated March 8, 2005	Incorporated by reference to Exhibit 10.17 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.32	Employment Letter from the Company to Wendy L. Schoppert dated March 15, 2005	Incorporated by reference to Exhibit 10.18 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.33	Employment Letter from the Company to Keith C. Spurgeon dated February 1, 2002	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly Report on Form 10-Q for the quarter ended March 30, 2002 (File No. 0-25121)
10.34	Summary of Executive Health Program	Incorporated by reference to Exhibit 10.36 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.35	Summary of Executive Tax and Financial Planning Program	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed January 3, 2005 (File No. 0-25121)
10.36	Select Comfort Corporation Executive Severance Pay Plan	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed February 26, 2007 (File No. 0-25121)

10.37	Summary of Non-Employee Director Compensation	Incorporated by reference to Exhibit 10.32 contained in Select Comfort's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)

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Exhibit No.	Description	Method Of Filing
10.38	Amended and Restated Select Comfort Corporation Non-Employee Director Equity Plan	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed May 1, 2006 (File No. 0-25121)
10.39	Supply Agreement dated October 3, 2006 between the Company and Supplier (1)	Filed herewith
10.40	Amended and Restated Private Label Consumer Credit Card Program Agreement dated as of December 14, 2005 between GE Money Bank and Select Comfort Corporation and Select Comfort Retail Corporation (2)	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed December 20, 2005 (File No. 0-25121)
10.41	Exclusive Supplier Agreement between Radisson Hotels International, Inc. and Select Comfort Corporation (2)	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Quarterly Report on Form 10-Q for the quarter ended July 3, 2004 (File No. 0-25121)
10.42	Credit Agreement dated as of June 9, 2006 among Select Comfort Corporation, the subsidiary borrowers from time to time party thereto, JPMorgan Chase Bank, National Association, as Administrative Agent, Bank of America, N.A., as Syndication Agent and JPMorgan Chase Bank, National Association, Bank of America, N.A., Citicorp USA, Inc., Wells Fargo Bank, National Association and Branch Banking and Trust Co., as Lenders	Incorporated by reference to Exhibit 10.1 contained in Select Comfort's Current Report on Form 8-K filed June 14, 2006 (File No. 0-25121)
21.1	Subsidiaries of the Company	Filed herewith
23.1	Consent of Independent Registered Public Accounting Firm	Filed herewith
24.1	Power of Attorney	Included on signature page
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith

(1) Confidential treatment has been requested with respect to designated portions contained within document. Such portions have been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities and Exchange Act of 1934, as amended.

(2) Confidential treatment has been granted by the Securities and Exchange Commission with respect to designated portions contained within document. Such portions have been omitted and filed separately with the Securities and Exchange Commission pursuant to Rule 24b-2 of the Securities and Exchange Act of 1934, as amended.

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SELECT COMFORT CORPORATION AND SUBSIDIARIES
Schedule II – Valuation and Qualifying Accounts
(in thousands)

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions From Reserves	Balance at End of Period
Allowance for doubtful accounts				
2006	$ 552	$ 676	$ 699	$ 529
2005	685	444	577	552
2004	619	404	338	685
Accrued sales returns (1)				
2006	$ 5,403	$ 42,508	$ 44,004	$ 3,907
2005	5,038	38,617	38,252	5,403
2004	3,469	37,297	35,728	5,038

(1) The decrease in accrued sales returns in fiscal 2006 compared to fiscal 2005 was principally due to a change in contractual terms with a wholesale customer.

SELECT COMFORT CORPORATION
2004 STOCK INCENTIVE PLAN

(Amended and Restated as of January 1, 2007)

1. Purpose of Plan.

The purpose of the Select Comfort Corporation 2004 Stock Incentive Plan (the "Plan") is to advance the interests of Select Comfort Corporation (the "Company") and its shareholders by enabling the Company and its Subsidiaries to attract and retain qualified individuals through opportunities for equity participation in the Company, and to reward those individuals who contribute to the achievement of the Company' objectives.

2. Definitions.

The following terms will have the meanings set forth below, unless the context clearly otherwise requires:

2.1 "Board" means the Board of Directors of the Company.

2.2 "Broker Exercise Notice" means a written notice pursuant to which a Participant, upon exercise of an Option, irrevocably instructs a broker or dealer to sell a sufficient number of shares or loan a sufficient amount of money to pay all or a portion of the exercise price of the Option and/or any related withholding tax obligations and remit such sums to the Company and directs the Company to deliver stock certificates to be issued upon such exercise directly to such broker or dealer or their nominee.

2.3 "Cause" means (i) dishonesty, fraud, misrepresentation, embezzlement or deliberate injury or attempted injury, in each case related to the Company or any Subsidiary, (ii) any unlawful or criminal activity of a serious nature, (iii) any intentional and deliberate breach of a duty or duties that, individually or in the aggregate, are material in relation to the Participant's overall duties, or (iv) any material breach of any employment, service, confidentiality or non-compete agreement entered into with the Company or any Subsidiary.

2.4 "Change in Control" means an event described in Section 12.1 of the Plan.

2.5 "Code" means the Internal Revenue Code of 1986, as amended.

2.6 "Committee" means the group of individuals administering the Plan, as provided in Section 3 of the Plan.

2.7 "Common Stock" means the common stock of the Company, par value $0.01 per share, or the number and kind of shares of stock or other securities into which such Common Stock may be changed in accordance with Section 4.3 of the Plan.

2.8 "Disability" means the disability of the Participant such as would entitle the Participant to receive disability income benefits pursuant to the long-term disability plan of the Company or Subsidiary then covering the Participant or, if no such plan exists or is applicable to

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the Participant, the permanent and total disability of the Participant within the meaning of Section 22(e)(3) of the Code.

2.9 "Effective Date" means May 20, 2004 or such later date as the Plan is initially approved by the Company's shareholders.

2.10 "Eligible Recipients" means all employees (including, without limitation, officers and directors who are also employees) of the Company or any Subsidiary and any non-employee directors, consultants and independent contractors of the Company or any Subsidiary. Non-employee directors shall only be eligible to participate through the limited, automatic grant provisions specified in Section 6.7 of the Plan.

2.11 "Exchange Act" means the Securities Exchange Act of 1934, as amended.

2.12 "Fair Market Value" means, with respect to the Common Stock, as of any date (or, if no shares were traded or quoted on such date, as of the next preceding date on which there was such a trade or quote): (a) the closing sale price of the Common Stock if the Common Stock is listed, admitted to unlisted trading privileges or reported on any foreign or national securities exchange or on the Nasdaq Global Select Market or Nasdaq Global Market or an equivalent foreign market on which sale prices are reported; (b) if the Common Stock is not so listed, admitted to unlisted trading privileges or reported, the closing bid price as reported by the Nasdaq Capital Market, OTC Bulletin Board or the National Quotation Bureau, Inc. or other comparable service; or (c) if the Common Stock is not so listed or reported, such price as the Committee determines in good faith in the exercise of its reasonable discretion. If determined by the Committee, such determination will be final, conclusive and binding for all purposes and on all persons, including, without limitation, the Company, the shareholders of the Company, the Participants and their respective successors-in-interest. No member of the Committee will be liable for any determination regarding the fair market value of the Common Stock that is made in good faith.

2.13 "Incentive Award" means an Option, Stock Appreciation Right, Restricted Stock Award or Performance Stock Award granted to an Eligible Recipient pursuant to the Plan.

2.14 "Incentive Stock Option" means a right to purchase Common Stock granted to an Eligible Recipient pursuant to Section 6 of the Plan that qualifies as an "incentive stock option" within the meaning of Section 422 of the Code.

2.15 "Non-Statutory Stock Option" means a right to purchase Common Stock granted to an Eligible Recipient pursuant to Section 6 of the Plan that does not qualify as an Incentive Stock Option.

2.16 "Option" means an Incentive Stock Option or a Non-Statutory Stock Option.

2.17 "Participant" means an Eligible Recipient who receives one or more Incentive Awards under the Plan.

2.18 "Performance Criteria" means the performance criteria that may be used by the Committee in granting Performance Stock Awards contingent upon achievement of performance

goals, consisting of net sales, operating income, income before income taxes, net income, net income per share (basic or diluted), profitability as measured by return ratios (including return on assets, return on equity, return on investment and return on sales), cash flows, market share, cost reduction goals, margins (including one or more of gross, operating and net income margins), stock price, total return to shareholders, economic value added, working capital and strategic plan development and implementation. The Committee may select one criterion or multiple criteria for measuring performance and the measurement may be based upon Company, Subsidiary or business unit performance, either absolute or by relative comparison to other companies or any other external measure of the selected criteria.

2.19 "Performance Stock Award" means an award of a right to receive shares of Common Stock granted to an Eligible Recipient pursuant to Section 9 of the Plan contingent upon achievement of Performance Criteria or other objectives during a specified period as provided in Section 9.

2.20 "Previously Acquired Shares" means shares of Common Stock that are already owned by the Participant or, with respect to any Incentive Award, that are to be issued upon the grant, exercise or vesting of such Incentive Award.

2.21 "Restricted Stock Award" means an award of Common Stock granted to an Eligible Recipient pursuant to Section 8 of the Plan that is subject to the restrictions on transferability and the risk of forfeiture imposed by the provisions of such Section 8.

2.22 "Retirement," unless otherwise defined in the instrument evidencing an Incentive Award or in a written employment, services or other agreement between the Participant and the Company or a Subsidiary, means "Retirement" as defined from time to time for purposes of the Plan by the Committee or by the Company's chief human resources officer or other person performing that function or, if not so defined, means voluntary termination of employment or service by the Participant on or after the date the Participant reaches age 55 with the present intention to leave the Company's industry and/or to leave the general workforce.

2.23 "Securities Act" means the Securities Act of 1933, as amended.

2.24 "Stock Appreciation Right" means a right granted to an Eligible Recipient pursuant to Section 7 of the Plan to receive a payment from the Company, in the form of stock, cash or a combination of both, equal to the difference between the Fair Market Value of one or more shares of Common Stock and the exercise price of such shares under the terms of such Stock Appreciation Right.

2.25 "Subsidiary" means any entity that is directly or indirectly controlled by the Company or any entity in which the Company has a significant equity interest, as determined by the Committee.

2.26 "Tax Date" means the date any withholding tax obligation arises under the Code for a Participant with respect to an Incentive Award.

3. Plan Administration.

3.1 The Committee. The Plan will be administered by the Board or by a committee of the Board. So long as the Company has a class of its equity securities registered under Section 12 of the Exchange Act, any committee administering the Plan will consist solely of two or more members of the Board who are "non-employee directors" within the meaning of Rule 16b-3 under the Exchange Act and, if the Board so determines in its sole discretion, who are "outside directors" within the meaning of Section 162(m) of the Code. Such a committee, if established, will act by majority approval of the members (provided, however, that unanimous approval shall be required with respect to any action taken by written consent), and a majority of the members of such a committee will constitute a quorum. As used in the Plan, "Committee" will refer to the Board or to such a committee, if established. To the extent consistent with applicable corporate law of the Company's jurisdiction of incorporation, the Committee may delegate to any officers of the Company the duties, power and authority of the Committee under the Plan pursuant to such conditions or limitations as the Committee may establish; provided, however, that only the Committee may exercise such duties, power and authority with respect to Eligible Recipients who are subject to Section 16 of the Exchange Act. The Committee may exercise its duties, power and authority under the Plan in its sole discretion without the consent of any Participant or other party, unless the Plan specifically provides otherwise. Each determination, interpretation or other action made or taken by the Committee pursuant to the provisions of the Plan will be conclusive and binding for all purposes and on all persons, and no member of the Committee will be liable for any action or determination made in good faith with respect to the Plan or any Incentive Award granted under the Plan.

3.2 Authority of the Committee.

(a) In accordance with and subject to the provisions of the Plan, the Committee will have the authority to determine all provisions of Incentive Awards as the Committee may deem necessary or desirable and as consistent with the terms of the Plan, including, without limitation, the following: (i) the Eligible Recipients to be selected as Participants; (ii) the nature and extent of the Incentive Awards to be made to each Participant (including the number of shares of Common Stock to be subject to each Incentive Award, any exercise price, the manner in which Incentive Awards will vest or become exercisable and whether Incentive Awards will be granted in tandem with other Incentive Awards) and the form of written agreement, if any, evidencing such Incentive Award; (iii) the time or times when Incentive Awards will be granted; (iv) the duration of each Incentive Award; and (v) the restrictions and other conditions to which the payment or vesting of Incentive Awards may be subject. In addition, the Committee will have the authority under the Plan in its sole discretion to pay the economic value of any Incentive Award in the form of cash, Common Stock or any combination of both.

(b) Subject to Section 3.2(d), below, the Committee will have the authority under the Plan to amend or modify the terms of any outstanding Incentive Award in any manner, including, without limitation, the authority to modify the number of shares or other terms and conditions of an Incentive Award, extend the term of an Incentive Award, accelerate the exercisability or vesting or otherwise terminate any restrictions relating to an Incentive Award, accept the surrender of any outstanding Incentive Award

or, to the extent not previously exercised or vested, authorize the grant of new Incentive Awards in substitution for surrendered Incentive Awards; provided, however that the amended or modified terms are permitted by the Plan as then in effect and that any Participant adversely affected by such amended or modified terms has consented to such amendment or modification.

(c) In the event of: (i) any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, extraordinary dividend or divestiture (including a spin off) or any other change in corporate structure or shares; (ii) any purchase, acquisition, sale, disposition or write-down of a significant amount of assets or a significant business; (iii) any change in accounting principles or practices, tax laws or other such laws or provisions affecting reported results; (iv) any uninsured catastrophic losses or extraordinary non-recurring items as described in Accounting Principles Board Opinion No. 30 or in management's discussion and analysis of financial performance appearing in the Company's annual report to shareholders for the applicable year; or (v) any other similar change, in each case with respect to the Company or any other entity whose performance is relevant to the grant or vesting of an Incentive Award, the Committee (or, if the Company is not the surviving corporation in any such transaction, the board of directors of the surviving corporation) may, without the consent of any affected Participant, amend or modify the vesting criteria (including Performance Criteria) of any outstanding Incentive Award that is based in whole or in part on the financial performance of the Company (or any Subsidiary or division or other subunit thereof) or such other entity so as equitably to reflect such event, with the desired result that the criteria for evaluating such financial performance of the Company or such other entity will be substantially the same (in the sole discretion of the Committee or the board of directors of the surviving corporation) following such event as prior to such event; provided, however, that the amended or modified terms are permitted by the Plan as then in effect.

(d) Notwithstanding any other provision of this Plan other than Section 4.3, the Committee may not, without prior approval of the Company's shareholders, seek to effect any re-pricing of any previously granted, "underwater" Option or Stock Appreciation Right by: (i) amending or modifying the terms of the Option or Stock Appreciation Right to lower the exercise price; (ii) canceling the underwater Option or Stock Appreciation Right and granting either (A) replacement Options or Stock Appreciation Rights having a lower exercise price; (B) Restricted Stock Awards; or (C) Performance Stock Awards in exchange; or (iii) repurchasing the underwater Options or Stock Appreciation Rights and granting new Incentive Awards under this Plan. For purposes of this Section 3.2(d), an Option or Stock Appreciation Right will be deemed to be "underwater" at any time when the Fair Market Value of the Common Stock is less than the exercise price of the Option or Stock Appreciation Right.

(e) In addition to the authority of the Committee under Section 3.2(b) and notwithstanding any other provision of the Plan, the Committee may, in its sole discretion, amend the terms of the Plan or Incentive Awards with respect to Participants resident outside of the United States or employed by a non-U.S. Subsidiary in order to

comply with local legal requirements, to otherwise protect the Company's or Subsidiary's interests, or to meet objectives of the Plan, and may, where appropriate, establish one or more sub-plans (including the adoption of any required rules and regulations) for the purposes of qualifying for preferred tax treatment under foreign tax laws. The Committee shall have no authority, however, to take action pursuant to this Section 3.2(e): (i) to reserve shares or grant Incentive Awards in excess of the limitations provided in Section 4.1; (ii) to effect any re-pricing in violation of Section 3.2(d); (iii) to grant Options or Stock Appreciation Rights having an exercise price less than 100% of the Fair Market Value of one share of Common Stock on the date of grant in violation of Section 6.2 or Section 7.2; or (iv) for which shareholder approval would then be required pursuant to Section 422 of the Code or the rules of any stock exchange on which shares of Common Stock may be listed for trading.

4. Shares Available for Issuance.

4.1 Maximum Number of Shares Available; Certain Restrictions on Awards. Subject to adjustment as provided in Section 4.3 of the Plan, the maximum number of shares of Common Stock that will be available for issuance under the Plan will be 4,500,000. Notwithstanding any other provisions of the Plan to the contrary, (i) no Participant in the Plan may be granted any Incentive Awards relating to more than 750,000 shares of Common Stock in the aggregate during any 12-month period; and (ii) no more than 1,500,000 shares of Common Stock may be granted as Restricted Stock Awards or Performance Stock Awards under the Plan, with the foregoing limits subject, in each case, to adjustment as provided in Section 4.3 of the Plan.

4.2 Accounting for Incentive Awards. Shares of Common Stock that are issued under the Plan or that are subject to outstanding Incentive Awards will be applied to reduce the maximum number of shares of Common Stock remaining available for issuance under the Plan; provided, however, that shares subject to an Incentive Award that lapses, expires, is forfeited (including issued shares forfeited under a Restricted Stock Award) or for any reason is terminated unexercised or unvested or is settled or paid in cash or any form other than shares of Common Stock will automatically again become available for issuance under the Plan. To the extent that the exercise price of any Incentive Award and/or associated tax withholding obligations are paid by tender or attestation as to ownership of Previously Acquired Shares, or to the extent that such tax withholding obligations are satisfied by withholding of shares otherwise issuable upon exercise of the Incentive Award, only the number of shares of Common Stock issued net of the number of shares tendered, attested to or withheld will be applied to reduce the maximum number of shares of Common Stock remaining available for issuance under the Plan. Similarly, any shares of Common Stock that are repurchased by the Company on the open market or in private transactions may be added to the aggregate number of shares available for issuance under the Plan, so long as the aggregate price paid for such repurchased shares does not exceed the cumulative amount received in cash by the Company upon the exercise of Options or issuance of Incentive Awards granted under the Plan.

4.3 Adjustments to Shares and Incentive Awards. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, divestiture or extraordinary dividend (including a spin off) or any other change

in the corporate structure or shares of the Company, the Committee (or, if

the Company is not the surviving corporation in any such transaction, the board of directors of the surviving corporation) will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) available for issuance or payment under the Plan and, in order to prevent dilution or enlargement of the rights of Participants, (a) the number and kind of securities or other property (including cash) subject to outstanding Incentive Awards, and (b) the exercise price of outstanding Incentive Awards.

5. Participation.

Participants in the Plan will be those Eligible Recipients who, in the judgment of the Committee, have contributed, are contributing or are expected to contribute to the achievement of the objectives of the Company or its Subsidiaries. Eligible Recipients may be granted from time to time one or more Incentive Awards, singly or in combination or in tandem with other Incentive Awards, as may be determined by the Committee in its sole discretion. Incentive Awards will be deemed to be granted as of the date specified in the grant resolution of the Committee, which date will be the date of any related agreement with the Participant.

6. Options.

6.1 Grant. An Eligible Recipient may be granted one or more Options under the Plan, and such Options will be subject to such terms and conditions, consistent with the other provisions of the Plan, as may be determined by the Committee in its sole discretion. The Committee may designate whether an Option is to be considered an Incentive Stock Option or a Non-Statutory Stock Option. To the extent that any Incentive Stock Option granted under the Plan ceases for any reason to qualify as an "incentive stock option" for purposes of Section 422 of the Code, such Incentive Stock Option will continue to be outstanding for purposes of the Plan but will thereafter be deemed to be a Non-Statutory Stock Option.

6.2 Exercise Price. The per share price to be paid by a Participant upon exercise of an Option will be determined by the Committee in its sole discretion at the time of the Option grant, provided that such price will not be less than 100% of the Fair Market Value of one share of Common Stock on the date of grant (110% of the Fair Market Value if, at the time the Incentive Stock Option is granted, the Participant owns, directly or indirectly, more than 10% of the total combined voting power of all classes of stock of the Company or any parent or subsidiary corporation of the Company).

6.3 Exercisability and Duration. An Option will become exercisable at such times and in such installments and upon such terms and conditions as may be determined by the Committee in its sole discretion at the time of grant, including without limitation (i) the achievement of one or more of the Performance Criteria; and/or that (ii) the Participant remain in the continuous employment or service with the Company or a Subsidiary for a certain period; provided, however, that no Option may be exercisable after 10 years from its date of grant.

6.4 Payment of Exercise Price. The total purchase price of the shares to be purchased upon exercise of an Option will be paid entirely in cash (including check, bank draft or money order); provided, however, that the Committee, in its sole discretion and upon terms and

conditions established by the Committee, may allow such payments to be made, in whole or in part, by tender of a Broker Exercise Notice, by tender, or attestation as to ownership, of Previously Acquired Shares that have been held for the period of time necessary to avoid a charge to the Company's earnings for financial reporting purposes and that are otherwise acceptable to the Committee, or by a combination of such methods. For purposes of such payment, Previously Acquired Shares tendered or covered by an attestation will be valued at their Fair Market Value on the exercise date.

6.5 Manner of Exercise. An Option may be exercised by a Participant in whole or in part from time to time, subject to the conditions contained in the Plan and in the agreement evidencing such Option, by delivery in person, by facsimile or electronic transmission or through the mail of written notice of exercise to the Company at its principal executive office in Minneapolis, Minnesota (or to the Company's designee as may be established from time to time by the Company and communicated to Participants) and by paying in full the total exercise price for the shares of Common Stock to be purchased in accordance with Section 6.4 of the Plan.

6.6 Aggregate Limitation of Stock Subject to Incentive Stock Options. To the extent that the aggregate Fair Market Value (determined as of the date an Incentive Stock Option is granted) of the shares of Common Stock with respect to which incentive stock options (within the meaning of Section 422 of the Code) are exercisable for the first time by a Participant during any calendar year (under the Plan and any other incentive stock option plans of the Company or any subsidiary or parent corporation of the Company (within the meaning of the Code)) exceeds $100,000 (or such other amount as may be prescribed by the Code from time to time), such excess Options will be treated as Non-Statutory Stock Options. The determination will be made by taking incentive stock options into account in the order in which they were granted. If such excess only applies to a portion of an Incentive Stock Option, the Committee, in its discretion, will designate which shares will be treated as shares to be acquired upon exercise of an Incentive Stock Option.

6.7 Non-Discretionary Grant of Options to Non-Employee Directors.

(a) Each non-employee director on the effective date of the Plan (or, if first elected after the effective date of the Plan, on the date the non-employee director is first elected) shall be awarded an Option to purchase up to 10,000 shares of Common Stock (or such lesser number of shares as may be determined by the Committee from time to time and subject to adjustment upon changes in capitalization of the Company as provided in Section 4.3 above). As of the close of business on each successive annual shareholders' meeting date after the date of the original award, each non-employee director continuing in service on the Board of Directors of the Company shall be granted an additional Option to purchase up to 10,000 shares of Common Stock (or such lesser number of shares as may be determined by the Committee from time to time and subject to adjustment upon changes in capitalization of the Company as provided in Section 4.3 above). All Options granted under this Section 6.7 of the Plan shall be Non-Statutory Stock Options not entitled to special tax treatment under Section 422 of the Internal Revenue Code of 1986, as amended.

(b) The per share price to be paid by the non-employee director upon exercise of an Option granted under this Section 6.7 will be equal to 100% of the Fair Market Value of the Common Stock on the date of grant.

(c) Subject to continuing service by the non-employee director on the Board of Directors of the Company, each Option granted under this Section 6.7 will vest one year after the date the Option is granted. If, for any reason, a non-employee director ceases to serve on the Board prior to the date an Option vests, such Option shall be forfeited and all further rights of the non-employee director to or with respect to such Option shall terminate. Each Option granted under this Section 6.7 shall expire ten (10) years from the date of grant, subject to earlier termination of the Option pursuant to the provisions of Section 10 of this Plan.

7. Stock Appreciation Rights.

7.1 Grant. An Eligible Recipient may be granted one or more Stock Appreciation Rights under the Plan, and such Stock Appreciation Rights will be subject to such terms and conditions, consistent with the other provisions of the Plan, as may be determined by the Committee in its sole discretion.

7.2 Exercise Price. The exercise price of a Stock Appreciation Right will be determined by the Committee, in its discretion, at the date of grant but may not be less than 100% of the Fair Market Value of one share of Common Stock on the date of grant.

7.3 Exercisability and Duration. A Stock Appreciation Right will become exercisable at such time and in such installments as may be determined by the Committee in its sole discretion at the time of grant; provided, however, that no Stock Appreciation Right may be exercisable after 10 years from its date of grant. A Stock Appreciation Right will be exercised by giving notice in the same manner as for Options, as set forth in Section 6.5 of the Plan.

8. Restricted Stock Awards.

8.1 Grant. An Eligible Recipient may be granted one or more Restricted Stock Awards under the Plan, and such Restricted Stock Awards will be subject to such terms and conditions, consistent with the other provisions of the Plan, as may be determined by the Committee in its sole discretion. The Committee may impose such restrictions or conditions, not inconsistent with the provisions of the Plan, to the vesting of such Restricted Stock Awards as it deems appropriate, including, without limitation, (i) the achievement of one or more of the Performance Criteria; and/or that (ii) the Participant remain in the continuous employment or service with the Company or a Subsidiary for a certain period. Notwithstanding the foregoing, no Restricted Stock Award shall vest within a period of less than three (3) years from the date of grant of the Restricted Stock Award.

8.2 Rights as a Stockholder; Transferability. Except as provided in Sections 8.1, 8.3, 8.4 and 13.3 of the Plan, upon a Participant becoming the holder of record of shares of Common Stock issued under a Restricted Stock Award pursuant to this Section 8, the Participant will have all voting, dividend, liquidation and other rights with respect to such shares (other than the right

to sell or transfer such shares) as if such Participant were a holder of record of shares of unrestricted Common Stock.

8.3 Dividends and Distributions. Unless the Committee determines otherwise in its sole discretion (either in the agreement evidencing the Restricted Stock Award at the time of grant or at any time after the grant of the Restricted Stock Award), any dividends or distributions (other than regular quarterly cash dividends) paid with respect to shares of Common Stock subject to the unvested portion of a Restricted Stock Award will be subject to the same restrictions as the shares to which such dividends or distributions relate. The Committee will determine in its sole discretion whether any interest will be paid on such dividends or distributions.

8.4 Enforcement of Restrictions. To enforce the restrictions referred to in this Section 8, the Committee may place a legend on the stock certificates referring to such restrictions and may require the Participant, until the restrictions have lapsed, to keep the stock certificates, together with duly endorsed stock powers, in the custody of the Company or its transfer agent, or to maintain evidence of stock ownership, together with duly endorsed stock powers, in a certificateless book entry stock account with the Company's transfer agent. Alternatively, Restricted Stock Awards may be held in non-certificated form pursuant to such terms and conditions as the Company may establish with its registrar and transfer agent and/or any third-party administrator designated by the Company to hold Restricted Stock Awards on behalf of Participants.

9. Performance Stock Awards.

An Eligible Recipient may be granted one or more Performance Stock Awards under the Plan, and the issuance of shares of Common Stock pursuant to such Performance Stock Awards will be subject to such terms and conditions, if any, consistent with the other provisions of the Plan, as may be determined by the Committee in its sole discretion, including, but not limited to, the achievement of one or more of the Performance Criteria. Notwithstanding the foregoing, no Performance Stock Award shall vest within a period of less than one (1) year from the date of grant of the Performance Stock Award.

10. Effect of Termination of Employment or Other Service.

10.1 Termination Due to Death or Disability. Unless otherwise expressly provided by the Committee in its sole discretion in the agreement evidencing an Incentive Award, and subject to Section 10.5 of the Plan, in the event a Participant's employment or other service with the Company and all Subsidiaries is terminated by reason of death or Disability:

(a) All outstanding Options and Stock Appreciation Rights then held by the Participant will become immediately exercisable in full and will remain exercisable for a period of two years after such termination (but in no event after the expiration date of any such Option or Stock Appreciation Right);

(b) All Restricted Stock Awards then held by the Participant will become fully vested; and

(c) Any conditions with respect to the issuance of shares of Common Stock pursuant to Performance Stock Awards will lapse.

10.2 Termination Due to Retirement. Unless otherwise expressly provided by the Committee in its sole discretion in the agreement evidencing an Incentive Award, and subject to Section 10.5 of the Plan, in the event a Participant's employment or other service with the Company and all Subsidiaries is terminated by reason of Retirement, then any Incentive Awards held by the Participant that vest over one or more incremental period or periods of more than one year in each incremental period shall be vested on a pro rata basis at the date of Retirement of the Participant, and:

(a) All outstanding Options and Stock Appreciation Rights then held by the Participant will, to the extent exercisable as of the date of Retirement, remain exercisable in full for a period of one year after the date of Retirement (but in no event after the expiration date of any such Option or Stock Appreciation Right). Options and Stock Appreciation Rights not exercisable as of the date of Retirement will be terminated and forfeited.

(b) All Restricted Stock Awards then held by the Participant that have not vested as of the date of Retirement will be terminated and forfeited; and

(c) All outstanding Performance Stock Awards then held by the Participant will be terminated and forfeited.

10.3 Termination for Reasons Other than Death, Disability or Retirement. Unless otherwise expressly provided by the Committee in its sole discretion in the agreement evidencing an Incentive Award, and subject to Section 10.5 of the Plan, in the event a Participant's employment or other service is terminated with the Company and all Subsidiaries for any reason other than death, Disability or Retirement, or a Participant is in the employment of a Subsidiary and the Subsidiary ceases to be a Subsidiary of the Company (unless the Participant continues in the employment of the Company or another Subsidiary):

(a) All outstanding Options and Stock Appreciation Rights then held by the Participant will, to the extent exercisable as of such termination, remain exercisable in full for a period of three months after such termination (but in no event after the expiration date of any such Option or Stock Appreciation Right). Options and Stock Appreciation Rights not exercisable as of such termination will be terminated and forfeited.

(b) All Restricted Stock Awards then held by the Participant that have not vested as of such termination will be terminated and forfeited; and

(c) All outstanding Performance Stock Awards then held by the Participant will be terminated and forfeited.

10.4 Modification of Rights upon Termination. Notwithstanding the other provisions of this Section 10, upon a Participant's termination of employment or other service with the Company and all Subsidiaries, the Committee may, in its sole discretion (which may be

exercised at any time on or after the date of grant, including following such termination), cause Options and/or Stock Appreciation Rights (or any part thereof) then held by such Participant to become or continue to become exercisable and/or remain exercisable following such termination of employment, and Restricted Stock Awards and/or Performance Stock Awards then held by such Participant to vest and/or continue to vest or become free of restrictions and conditions to issuance, as the case may be, following such termination of employment, in each case in the manner determined by the Committee; provided, however, that no Option or Stock Appreciation Right may remain exercisable beyond its expiration date.

10.5 Effects of Actions Constituting Cause. Notwithstanding anything in the Plan to the contrary, in the event that a Participant is determined by the Committee, acting in its sole discretion, to have committed any action which would constitute Cause as defined in Section 2.3, irrespective of whether such action or the Committee's determination occurs before or after termination of such Participant's employment or other service with the Company or any Subsidiary, all rights of the Participant under the Plan and any agreements evidencing an Incentive Award then held by the Participant shall terminate and be forfeited without notice of any kind. The Company may defer the exercise of any Option or Stock Appreciation Right, the vesting of any Restricted Stock Award or the issuance of any shares of Common Stock pursuant to any Performance Stock Award for a period of up to forty-five (45) days in order for the Committee to make any determination as to the existence of Cause.

10.6 Determination of Date of Termination. Unless the Committee otherwise determines in its sole discretion, a Participant's employment or other service will, for purposes of the Plan, be deemed to have terminated on the date recorded on the personnel or other records of the Company or the Subsidiary for which the Participant provides employment or other services, as determined by the Committee in its sole discretion based upon such records.

11. Payment of Withholding Taxes.

11.1 General Rules. The Company is entitled to (a) withhold and deduct from future wages of the Participant (or from other amounts that may be due and owing to the Participant from the Company or a Subsidiary), or make other arrangements for the collection of, all legally required amounts necessary to satisfy any and all federal, foreign, state and local withholding and employment related tax requirements attributable to an Incentive Award, including, without limitation, the grant, exercise or vesting of, or payment of dividends with respect to, an Incentive Award or a disqualifying disposition of stock received upon exercise of an Incentive Stock Option, or (b) require the Participant promptly to remit the amount of such withholding to the Company before taking any action, including issuing any shares of Common Stock, with respect to an Incentive Award.

11.2 Special Rules. The Committee may, in its sole discretion and upon terms and conditions established by the Committee, permit or require a Participant to satisfy, in whole or in part, any withholding or employment related tax obligation described in Section 11.1 of the Plan by electing to tender, or by attestation as to ownership of, Previously Acquired Shares that have been held for the period of time necessary to avoid a charge to the Company's earnings for

financial reporting purposes and that are otherwise acceptable to the Committee, by delivery of a Broker Exercise Notice or a combination of such methods. For purposes of satisfying a

Participant's withholding or employment-related tax obligation, Previously Acquired Shares tendered or covered by an attestation will be valued at their Fair Market Value.

12. Change in Control.

12.1 Change in Control. For purposes of this Section 12, a "Change in Control" of the Company shall mean (a) the sale, lease, exchange or other transfer of all or substantially all of the assets of the Company (in one transaction or in a series of related transactions) to a corporation that is not controlled by the Company, (b) the approval by the shareholders of the Company of any plan or proposal for the liquidation or dissolution of the Company, or (c) a change in control of a nature that would be required to be reported (assuming such event has not been "previously reported") in response to Item 1(a) of the Current Report on Form 8-K, as in effect on the effective date of the Plan, pursuant to Section 13 or 15(d) of the Exchange Act, whether or not the Company is then subject to such reporting requirement; provided that, without limitation, such a Change in Control shall be deemed to have occurred at such time as (x) any Person becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act) directly or indirectly, of 50% or more of the combined voting power of the Company's outstanding securities ordinarily having the right to vote at elections of directors or (y) individuals who constitute the Board of Directors on the effective date of the Plan cease for any reason to constitute at least a majority thereof, provided that any person becoming a director subsequent to the effective date of the Plan whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the directors comprising the Board of Directors on the effective date of the Plan (either by a specific vote or by approval of the proxy statement of the Company in which such person is named as a nominee for director, without objection to such nomination) shall be, for purposes of this clause (y), considered as though such person were a member of the Board of Directors on the effective date of the Plan.

12.2 Acceleration of Vesting. Without limiting the authority of the Committee under Sections 3.2 and 4.3 of the Plan, if a Change in Control of the Company occurs, then, unless otherwise provided by the Committee in its sole discretion either in the agreement evidencing an Incentive Award at the time of grant or at any time after the grant of an Incentive Award, (a) all outstanding Options and Stock Appreciation Rights will become immediately exercisable in full and will remain exercisable for the remainder of their terms, regardless of whether the Participant to whom such Options or Stock Appreciation Rights have been granted remains in employment or service with the Company or any Subsidiary; (b) all outstanding Restricted Stock Awards will become immediately fully vested and non-forfeitable; and (c) all outstanding Performance Stock Awards will vest and/or continue to vest in the manner determined by the Committee and set forth in the respective agreements evidencing such Performance Stock Awards.

12.3 Cash Payment for Options. If a Change in Control of the Company occurs, then the Committee, if approved by the Committee in its sole discretion either in an agreement evidencing an Incentive Award at the time of grant or at any time after the grant of an Incentive Award, and without the consent of any Participant effected thereby, may determine that some or all Participants holding outstanding Options will receive, with respect to some or all of the shares of Common Stock subject to such Options, as of the effective date of any such Change in Control

of the Company, cash in an amount equal to the excess of the Fair Market Value of such shares immediately prior to the effective date of such Change in Control of the Company over the exercise price per share of such Options.

13. Rights of Eligible Recipients and Participants; Transferability.

13.1 Employment. Nothing in the Plan will interfere with or limit in any way the right of the Company or any Subsidiary to terminate the employment of any Eligible Recipient or Participant at any time, nor confer upon any Eligible Recipient or Participant any right to continue in employment with the Company or any Subsidiary.

13.2 Rights as a Stockholder. As a holder of Incentive Awards (other than Restricted Stock Awards), a Participant will have no rights as a shareholder unless and until such Incentive Awards are exercised for, or paid in the form of, shares of Common Stock and the Participant becomes the holder of record of such shares. Except as otherwise expressly provided in the Plan and except as the Committee may determine in its sole discretion, no adjustment will be made for dividends or distributions with respect to such Incentive Awards as to which there is a record date preceding the date the Participant becomes the holder of record of such shares.

13.3 Restrictions on Transfer.

(a) Except pursuant to testamentary will or the laws of descent and distribution or as otherwise expressly permitted by subsections (b) and (c) below, no right or interest of any Participant in an Incentive Award prior to the exercise (in the case of Options or Stock Appreciation Rights) or vesting or issuance (in the case of Restricted Stock Awards and Performance Stock Awards) of such Incentive Award will be assignable or transferable, or subjected to any lien, during the lifetime of the Participant, either voluntarily or involuntarily, directly or indirectly, by operation of law or otherwise.

(b) A Participant will be entitled to designate a beneficiary to receive an Incentive Award upon such Participant's death, and in the event of such Participant's death, payment of any amounts due under the Plan will be made to, and exercise of any Options or Stock Appreciation Rights (to the extent permitted pursuant to Section 10 of the Plan) may be made by, such beneficiary. If a deceased Participant has failed to designate a beneficiary, or if a beneficiary designated by the Participant fails to survive the Participant, payment of any amounts due under the Plan will be made to, and exercise of any Options or Stock Appreciation Rights (to the extent permitted pursuant to Section 10 of the Plan) may be made by, the Participant's legal representatives, heirs and legatees. If a deceased Participant has designated a beneficiary and such beneficiary survives the Participant but dies before complete payment of all amounts due under the Plan or exercise of all exercisable Options or Stock Appreciation Rights, then such payments will be made to, and the exercise of such Options or Stock Appreciation Rights may be made by, the legal representatives, heirs and legatees of the beneficiary.

(c) Upon a Participant's request, the Committee may, in its sole discretion, permit a transfer of all or a portion of a Non-Statutory Stock Option or Stock Appreciation Right, other than for value, to such Participant's child, stepchild,

grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, any person sharing such Participant's household (other than a tenant or employee), a trust in which any of the foregoing have more than fifty percent (50%) of the beneficial interests, a foundation in which any of the foregoing (or the Participant) control the management of assets, and any other entity in which these persons (or the Participant) own more than fifty percent (50%) of the voting interests. Any permitted transferee will remain subject to all the terms and conditions applicable to the Participant prior to the transfer. A permitted transfer may be conditioned upon such requirements as the Committee may, in its sole discretion, determine, including, but not limited to execution and/or delivery of appropriate acknowledgements, opinion of counsel, or other documents by the transferee.

13.4 Non-Exclusivity of the Plan. Nothing contained in the Plan is intended to modify or rescind any previously approved compensation plans or programs of the Company or create any limitations on the power or authority of the Board to adopt such additional or other compensation arrangements as the Board may deem necessary or desirable.

14. Securities Law and Other Restrictions.

Notwithstanding any other provision of the Plan or any agreements entered into pursuant to the Plan, the Company will not be required to issue any shares of Common Stock under this Plan, and a Participant may not sell, assign, transfer or otherwise dispose of shares of Common Stock issued pursuant to Incentive Awards granted under the Plan, unless (a) there is in effect with respect to such shares a registration statement under the Securities Act and any applicable securities laws of a state or foreign jurisdiction or an exemption from such registration under the Securities Act and applicable state or foreign securities laws, and (b) there has been obtained any other consent, approval or permit from any other U.S. or foreign regulatory body which the Committee, in its sole discretion, deems necessary or advisable. The Company may condition such issuance, sale or transfer upon the receipt of any representations or agreements from the parties involved, and the placement of any legends on certificates representing shares of Common Stock, as may be deemed necessary or advisable by the Company in order to comply with such securities law or other restrictions.

15. Performance-Based Compensation Provisions.

The Committee, when it is comprised solely of two or more outside directors meeting the requirements of Section 162(m) of the Code ("Section 162(m)"), in its sole discretion, may designate whether any Incentive Awards are intended to be "performance-based compensation" within the meaning of Section 162(m). Any Incentive Awards so designated will, to the extent required by Section 162(m), be conditioned upon the achievement of one or more Performance Criteria, and such Performance Criteria will be established by the Committee within the time period prescribed by, and will otherwise comply with the requirements of, Section 162(m) giving due regard to the disparate treatment under Section 162(m) of Options and Stock Appreciation Rights (where compensation is determined based solely on an increase in the value of the underlying stock after the date of grant or award), as compared to other forms of compensation, including Restricted Stock Awards and Performance Stock Awards. The Committee shall also

certify in writing that such Performance Criteria have been met prior to payment of compensation to the extent required by Section 162(m).

16. Plan Amendment, Modification and Termination.

The Board may suspend or terminate the Plan or any portion thereof at any time. In addition to the authority of the Committee to amend the Plan under Section 3.2(e), the Board may amend the Plan from time to time in such respects as the Board may deem advisable in order that Incentive Awards under the Plan will conform to any change in applicable laws or regulations or in any other respect the Board may deem to be in the best interests of the Company; provided, however, that no such amendments to the Plan will be effective without approval of the Company's shareholders if: (i) shareholder approval of the amendment is then required pursuant to Section 422 of the Code or the rules of the primary stock exchange or stock market on which the Common Stock is then traded; or (ii) such amendment would: (A) modify Section 3.2(d) hereof; (B) materially increase benefits accruing to Participants; (C) increase the aggregate number of shares issued or issuable under the Plan; or (D) modify the eligibility requirements for Participants in the Plan. No termination, suspension or amendment of the Plan may adversely affect any outstanding Incentive Award without the consent of the affected Participant; provided, however, that this sentence will not impair the right of the Committee to take whatever action it deems appropriate under Sections 3.2(c), 4.3 and 12 of the Plan.

17. Effective Date and Duration of the Plan.

The Plan is effective as of the Effective Date. The Plan will terminate at midnight on May 20, 2014, and may be terminated prior to such time by Board action. No Incentive Award will be granted after termination of the Plan. Incentive Awards outstanding upon termination of the Plan may continue to be exercised, or become free of restrictions, according to their terms.

18. Miscellaneous.

18.1 Governing Law. Except to the extent expressly provided herein or in connection with other matters of corporate governance and authority (all of which shall be governed by the laws of the Company's jurisdiction of incorporation), the validity, construction, interpretation, administration and effect of the Plan and any rules, regulations and actions relating to the Plan will be governed by and construed exclusively in accordance with the laws of the State of Minnesota, notwithstanding the conflicts of laws principles of any jurisdictions.

18.2 Successors and Assigns. The Plan will be binding upon and inure to the benefit of the successors and permitted assigns of the Company and the Participants.

EXHIBIT 10.20

Nonstatutory Stock Option Award Agreement
(Subject to Performance Adjustment)

_____ , 2007

[Name]

Re: Nonstatutory Options to Purchase Shares of Common Stock of Select Comfort Corporation

In recognition of your contributions to the ultimate success of our Company, and to enable you to share in that success, the Board of Directors has approved the grant to you of nonstatutory stock options under the Company's 2004 Stock Incentive Plan (the "Plan"). This letter serves as formal documentation of these stock options, giving you the right to purchase up to _____ ( ) shares of the Company's Common Stock at a price of $XX.XX per share, subject to the performance adjustment described below, vesting provisions and other terms and conditions of this letter and the Plan.

The number of stock options granted hereunder is subject to adjustment based on the Company's net operating profit performance in fiscal year 2007 (the "Performance Period"). Based on the Company's actual net operating profit during the Performance Period as a percentage of Targeted Net Operating Profit during the Performance Period, the number of stock options will be multiplied by the factor set forth in the table below to determine the "Adjusted Stock Options." For purposes of this Agreement, Targeted Net Operating Profit shall mean the amount of net operating profit that would result in payment of the annual cash incentive payment under the Select Comfort Corporation Executive and Key Employee Incentive Plan at the 100% of target level.

Actual 2007 Net Operating Profit as a Percentage of Targeted Net Operating Profit	Factor to Multiply Stock Options by to Arrive at Adjusted Stock Options
Greater than 125% of Plan	1.50X
Greater than 115% up to 125% of Plan	1.25X
Greater than 105% up to 115% of Plan	1.10X
Greater than 95% up to 105% of Plan	1.00X
Greater than 85% up to 95% of Plan	0.90X
Greater than 75% up to 85% of Plan	0.80X
Greater than 65% up to 75% of Plan	0.75X
Up to 65% of Plan	0.25X

For example, if the stock options consist of 1,000 shares of Common Stock, and the Company's actual net operating profit in 2007 is equal to 112% of Targeted Net Operating Profit, then the Adjusted Stock Options would consist of 1,100 shares of Common Stock (1,000 X 1.10 = 1,100).

The options granted under this letter will become exercisable, or "vest," in installments of one-fourth ($1/4^{th}$) of the total number of option shares as of each of the first four (4) anniversaries of the date of this letter, so long as you remain continuously employed by the Company, except as otherwise set forth below. Your rights to exercise these options will terminate as to all

unexercised options at 5:00 p.m. (Minneapolis, Minnesota time) on _____ , 2017 (the "Expiration Date"), subject to earlier termination as described below or in the Plan.

The vesting and termination provisions of the options granted hereby will be impacted by the termination of your employment, depending on the reason for termination of your employment, as described below:

Retirement. If your employment is terminated upon your retirement, then:

(a) If your retirement is at or beyond normal retirement age (60) and you have ten (10) or more years of service with the Company prior to retirement, then the options will continue to vest following retirement in accordance with the schedule described above. Options that are vested will remain exercisable for up to three (3) years after retirement, but not beyond the Expiration Date.

(b) If your retirement is at or beyond normal retirement age (60) and you have less than ten (10) years of service with the Company prior to retirement, then the options will be vested pro rata based on the number of months elapsed in the four-year vesting period as of the date of retirement (e.g., if retirement occurs 32 months into the 48 month vesting period, then 2/3rds of the options will be vested). Options that are vested will remain exercisable for up to three (3) years after retirement, but not beyond the Expiration Date.

(c) If your retirement is at or beyond early retirement age (55) and you have five (5) or more years of service with the Company prior to retirement, then the options will be vested pro rata based on the number of months elapsed in the four-year vesting period as of the date of retirement (e.g., if retirement occurs 32 months into the 48 month vesting period, then 2/3rds of the options will be vested). Options that are vested will remain exercisable for up to one (1) year after retirement, but not beyond the Expiration Date.

(d) Any retirement from the Company that does not meet any of the requirements above will be considered a voluntary termination other than upon retirement as described below.

Voluntary Termination other than upon Retirement. If your employment is terminated voluntarily by you (other than upon retirement meeting the requirements described above), options that are vested as of the date of termination of employment will remain exercisable for up to three (3) months after your employment ends, but not beyond the Expiration Date.

Termination by the Company other than for Cause. If your employment is terminated by the Company (other than for "cause," as defined in the Plan), options that are vested as of the date of termination of employment will remain exercisable for up to three (3) months after your employment ends, but not beyond the Expiration Date.

Termination by the Company for Cause. If your employment is terminated by the Company for "cause," as defined in the Plan, all of your rights under this letter agreement and the options granted hereby will immediately terminate without notice of any kind.

Termination due to Death or Disability. If your employment is terminated due to death or "disability," as defined in the Plan, all of the options will become immediately exercisable in full and will remain exercisable for up to two (2) years after termination of employment, but not beyond the Expiration Date.

The Company is not required to give you notice of the termination of your options under any of the foregoing circumstances.

Following the exercise by you of your rights to purchase shares under these stock options, the shares purchased by you will be freely tradable, subject to the Company's policies and SEC rules regarding insider trading. Executive officers and members of the Board of Directors are required to comply with SEC Rule 144 in connection with any sale of shares received upon the exercise of any stock options.

Withholding Taxes. The Company is entitled to (a) withhold and deduct from your future wages (or from other amounts that may be due and owing to you from the Company), or make other arrangements for the collection of all legally required amounts necessary to satisfy any federal, state or local withholding and employment-related tax requirements attributable to the exercise of the options, or (b) require you to promptly remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, you agree to pay to the Company an amount equal to the amount the Company would otherwise be required to withhold under federal, state or local law.

There may be income tax consequences resulting from the exercise of the stock options or sale of the shares received upon the exercise of the stock options. You are urged to consult with your individual tax advisor regarding any tax consequences.

These options are granted under the Company's 2004 Stock Incentive Plan, and are subject to all of the terms and conditions applicable to stock options granted under the Plan. We have enclosed, for your records, a copy of the Plan, the Prospectus for the Plan, the Company's most recent Annual Report on Form 10-K and the Company's most recent Proxy Statement.

Please note that your rights to exercise your options will become void and will expire as to all unexercised options at 5:00 p.m. (Minneapolis, Minnesota time) on _____ , 2017, subject to earlier termination as set forth above or in the Plan.

Very truly yours,

William R. McLaughlin
Chairman & CEO

By signing this letter, I acknowledge the terms of the stock options granted under this letter, and acknowledge receipt of a copy of the Company's 2004 Stock Incentive Plan and the other documents referred to above.

_____
(Signature)

EXHIBIT 10.22

SELECT COMFORT
PROFIT SHARING AND 401(K) PLAN

Third Declaration of Amendment

Pursuant to the retained power of amendment contained in Section 11.2 of the "Select Comfort Profit Sharing and 401(k) Plan – 2005 Restatement" (the "Plan"), the undersigned amends the Plan by way of restatement in the manner set forth in the instrument entitled "Select Comfort Profit Sharing and 401(k) Plan – 2007 Restatement" (the "Plan") attached hereto.

Except as otherwise specifically provided in the Plan, the foregoing amendment is effective as of the Restatement Date as defined in the Plan and applies to all Participants.

The undersigned has caused this instrument to be executed by its duly authorized officer this 1st day of January, 2007.

SELECT COMFORT CORPORATION

By /s/ Mark A. Kimball
Its Senior Vice President

SELECT COMFORT
PROFIT SHARING AND 401(K) PLAN
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SELECT COMFORT
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ARTICLE 1.
DESCRIPTION AND PURPOSE

1.1. ***Plan Name***. The name of the Plan is the "Select Comfort Profit Sharing and 401(k) Plan."

1.2. ***Plan Description***. The Plan is a single plan consisting of a profit sharing portion and stock bonus portion. 401(k) Contributions pursuant to a qualified cash or deferred arrangement, Matching Contributions and discretionary Profit Sharing Contributions are made to the profit sharing portion of the Plan. The stock bonus portion of the Plan constitutes an employee stock ownership plan within the meaning of Code section 4975(e)(7) and is designed to invest exclusively in Company common stock except for cash held pending investment, transfer or distribution. All amounts invested in the Company Stock Fund are automatically transferred from the profit sharing portion of the plan to the stock bonus portion of the Plan. The Plan is intended to qualify under Code section 401(a) and to satisfy the requirements of Code sections 401(k), 401(m) and 4975(e)(7). Notwithstanding the designation of a portion of the Plan as a profit sharing plan, a Participating Employer may make contributions to the Plan even though such employer has no current or accumulated earnings and profits.

1.3. ***Plan Effective Date***. The Plan was originally effective January 1, 1994.

1.4. ***Plan Background***

(a) Since January 1, 1994, the Plan has been amended and restated from time to time. The Plan was amended and restated for law changes as required by the Uruguay Round Agreements Act of 1994, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, and the Internal Revenue Restructuring and Reform Act of 1998, and the Community Renewal Tax Relief Act of 2000, collectively referred to as the "GUST" amendments, to reflect certain provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and to make certain other miscellaneous changes.

(b) The Plan was restated, generally effective as of October 1, 2005. Pursuant to this restatement, the Plan is a single profit sharing plan consisting of a profit sharing portion and stock bonus portion. The stock bonus portion of the Plan constitutes an employee stock ownership plan within the meaning of Code section 4975(e)(7) and is designed to invest exclusively in Company common stock except for cash held pending investment, transfer or distribution.

(c) The Plan was amended, effective January 1, 2006, to comply with final Treasury Regulations issued under Code sections 401(k) and 401(m).

(d) The Plan is amended, effective as of the Restatement Date, to comply with the cumulative list published by the Internal Revenue Service in Notice 2005-101 and create the Plan's EGTRRA restatement.

1.5. ***Plan Purposes***

(a) The purposes of the Plan are to encourage savings by Employees on a tax effective basis for retirement, disability and other contingencies, in order to supplement other Company and government sponsored benefit programs; assist Employees in acquiring greater financial security; and increase the proprietary interest of Employees in the Company by providing a means for the ownership and accumulation of Company common stock.

(b) The Plan and Trust are intended to meet the requirements of sections 401(a), 401(k), 401(m), 501(a) and 4975(e)(7) of the Code, as well as the applicable provisions of ERISA; and are subject to approval by the Internal Revenue Service and to any amendments necessary to obtain such approval.

(c) No shares of Company common stock will be acquired under this Plan with the proceeds of an ESOP stock loan.

ARTICLE 2.
ELIGIBILITY

2.1. ***Eligibility Requirements***.

(a) An Employee who was a Participant in the Plan the day before the Restatement Date shall continue as a Participant in the Plan.

(b) An Employee who is a Qualified Employee, other than any Employee who is classified by the Company as a temporary or Part-Time Employee, is eligible to participate in the Plan:

(i) for the purpose of making a rollover contribution pursuant to Section 3.5 on the day on which he or she first completes an Hour of Active Service; and

(ii) for the purposes of making 401(k) Contributions and having Matching Contributions and Profit Sharing Contributions made on his or her behalf, the date the Employee completes 30 days of continuous employment after the date he or she completes an Hour of Active Service (or, if earlier, the date the Employee completes 1,000 Hours of Service during the "eligibility service period" described in Section 2.1(c)(ii)) or, if later, the date the Employee attains age 21.

(c) An Employee who is a Qualified Employee and who is classified by the Company as a temporary or Part-Time Employee is eligible to participate in the Plan:

(i) for the purpose of making a rollover contribution pursuant to Section 3.5 on the day on which he or she first completes an Hour of

Active Service; and

(ii) for the purposes of making 401(k) Contributions and having Matching Contributions and Profit Sharing Contributions made on his or her behalf, on the last day of the first "eligibility service period" during which he or she completes at least 1,000 Hours of Service and has attained age 21. An Employee's "eligibility service period" is the 12-month period that starts on the day on which he or she first completes an Hour of Active Service and, if the Employee fails to complete at least 1,000 Hours of Service during this period, then Plan Years, beginning with the Plan Year that includes the first anniversary of the day on which he or she first completes an Hour of Active Service.

(d) Service with an entity (all or any portion of which is acquired by, merges with or becomes an Affiliated Organization) for any period prior to the date of the acquisition, merger or affiliation will be taken into account under this Plan only if, to the extent and for the purposes, specified on an exhibit to the Plan, as provided for in Section 14.1(f).

2.2. ***Entry Date***.

(a) An Employee will enter the Plan as an Active Participant for the purpose of making a rollover contribution pursuant to Section 3.5, on the day on which he or she first completes an Hour of Active Service as a Qualified Employee.

(b) An Employee will enter the Plan as an Active Participant for the purposes of making 401(k) Contributions and having Matching Contributions and Profit Sharing Contributions made on his or her behalf on the first day of the calendar month that first follows the day on which he or she satisfies the applicable eligibility requirements specified in Section 2.1(b)(ii) or Section 2.1(c)(ii), if he or she is a Qualified Employee on the day on which he or she would otherwise enter the Plan.

(c) If an Employee described in Section 2.1(b)(ii) or Section 2.1(c)(ii) terminates employment before the day on which he or she would otherwise be eligible to enter the Plan for the purposes of making 401(k) Contributions and having Matching Contributions and Profit Sharing Contributions made on his or her behalf and again becomes an Employee after that day, then:

(i) if he or she terminated employment before satisfying the 30 days of continuous employment eligibility requirement specified in Section 2.1(b)(ii), he or she will be treated as a new Employee and his or her previous service will be disregarded in determining his or her new 30 day continuous employment eligibility service period pursuant to Section 2.1(b)(ii); or

(ii) if he or she terminated employment after satisfying the eligibility requirements specified in Section 2.1(b)(ii) or Section 2.1(c)(ii), he or she will enter the Plan as an Active Participant as of the first following day on which he or she completes an Hour of Active Service as a Qualified Employee.

(d) If an Employee is not a Qualified Employee on the day on which he or she would otherwise enter the Plan for a particular purpose, he or she will enter the Plan as an Active Participant for that purpose on the first following day on which he or she completes an Hour of Active Service as a Qualified Employee.

2.3. ***Special Entry Dates***. Notwithstanding Sections 2.1 and 2.2, in conjunction with an acquisition, the Administrator may specify a special entry date for one or more purposes for individuals who become Qualified Employees on account of the acquisition.

2.4. ***Transfer Among Participating Employers***. A Participant who transfers from one Participating Employer to another Participating Employer as a Qualified Employee will participate in the Plan for the Plan Year during which the transfer occurs on the basis of his or her separate Eligible Earnings for the Plan Year from each Participating Employer.

2.5. ***Multiple Employments***. A Participant who is simultaneously employed as a Qualified Employee with more than one Participating Employer will participate in the Plan as a Qualified Employee of all of his or her Participating Employers on the basis of his or her separate Eligible Earnings from each Participating Employer.

2.6. ***Reentry***. A Participant for a particular purpose who ceases to be a Qualified Employee will resume active participation in the Plan for that purpose on the first day on which he or she completes an Hour of Active Service as a Qualified Employee.

2.7. ***Condition of Participation***. Each Qualified Employee, as a condition of participation, is bound by all of the terms and conditions of the Plan and must furnish to the Administrator such pertinent information and execute such instruments as the Administrator may require.

2.8. ***Termination of Participation***. A Participant will cease to be a Participant as of the later of the date on which:

(a) he or she ceases to be a Qualified Employee; or

(b) all benefits, if any, to which he or she is entitled under the Plan have been forfeited or distributed.

ARTICLE 3.

CONTRIBUTIONS

3.1. ***401(k) Contributions***.

(a) Subject to the limitations described in Article 9, for each Plan Year an Active Participant may elect, or may be deemed to have elected, to make 401(k) Contributions for the Plan Year in accordance with the succeeding provisions of this section. 401(k) Contributions will be paid by the Participating Employer to the Trustee as soon as administratively practicable after the date on which the Active Participant would have received the Eligible Earnings but for his or her election pursuant to this section.

(b) A reference in this section to an election to make 401(k) Contributions means that the Participant has elected to have his or her Eligible Earnings reduced in consideration of the Participating Employer's obligation to make 401(k) Contributions in the same amount on the Participant's behalf. Except as provided in subsection (c), a Participant's 401(k) Contributions will be made in accordance with the rules in this subsection.

(i) An Active Participant may elect to make 401(k) Contributions in any one percent increment from one percent to a maximum percentage specified in Plan Rules, and the elected percentage will automatically apply to the Active Participant's Eligible Earnings as adjusted from time to time. Plan Rules may specify a maximum percentage for Active Participants who are Highly Compensated Employees that is less than the maximum percentage specified for Active Participants who are not Highly Compensated Employees. No 401(k) Contributions will be made on behalf of a Participant with respect to a period during which he or she is not an Active Participant.

(ii) An Active Participant may elect not to make 401(k) Contributions.

(iii) Each individual who:

(1) first becomes a Qualified Employee after April 30, 2006;

(2) has satisfied the eligibility rules set forth in Article 2; and

(3) has not made an election under clause (i) or clause (ii)

will be deemed to have elected to make 401(k) Contributions in the amount of two percent of the Active Participant's Eligible Earnings beginning as of the first payroll paid 30 days after the date such Active Participant enters the Plan pursuant to Section 2.2.

To the extent required by Internal Revenue Service rules, the Administrator will provide notice to each Active Participant who was deemed to have made an election to participate in the Plan as described above, the timing and content of such notice determined in accordance with Internal Revenue Service rules.

(iv) At least once per Plan Year, an Active Participant may make an election to commence 401(k) Contributions pursuant to clause (i) or not make 401(k) Contributions pursuant to clause (ii) and such election will become effective at the time and manner specified in Plan Rules after the Administrator receives a complete and accurate election..

(v) At least once per Plan year, an Active Participant may elect to change the percentage rate of his or her 401(k) Contributions. The election will become effective at the time and manner specified in Plan Rules after the Administrator receives a complete and accurate election of such change.

(vi) 401(k) Contributions for an Active Participant who makes a hardship withdrawal pursuant to Section 6.1 will be automatically suspended for the six month period beginning on the date of the withdrawal. Following the suspension period the Active Participant may again elect to make 401(k) Contributions in accordance with clause (v).

(c) Only Eligible Earnings payable after an Active Participant's complete and accurate election has been received and become effective (or as of the deemed election effective date) will be reduced pursuant to the election (or deemed election). If any election is not processed on a timely basis, or if, for any reason, an Active Participant's Eligible Earnings are not reduced in accordance with the Participant's election, no

retroactive adjustments will be made to take into account the effect of any such delay or failure. Plan Rules, however, may permit an Active Participant to elect to make 401(k) Contributions from his or her Eligible Earnings payable during any remaining portion of the Plan Year during which the delay or failure occurred at more than the otherwise applicable maximum percentage to adjust for the effect of the delay or failure so long as the total reductions for the Plan Year do not exceed the applicable maximum percentage or the limitations described in Article 9. Except as allowed in Treasury Regulations, 401(k) Contributions will not be paid to the Trustee prior to the date the Active Participant performs the services with respect to which the 401(k) Contribution election relates."

(d) 401(k) Contributions are made to the profit sharing portion of the Plan; any amounts invested in the Company Stock Fund are transferred from the profit sharing portion of the Plan to the stock bonus portion of the Plan and considered part of the Participant's ESOP Account.

3.2. ***Catch-Up Contributions***.

(a) Each Participant who has attained age 49 before the first day of a Plan Year may elect for such Plan Year to make Catch-Up Contributions, which consist of Eligible Earnings reductions and corresponding 401(k) Contributions in excess of any of the limitations of Article 9 or of a percentage limitation of Section 3.1.

(b) Catch-Up Contributions elected by a Participant for any Plan Year may not exceed the lesser of:

(i) the applicable dollar amount specified in Code section 414(v) and

(ii) the excess of the Participant's Eligible Earnings over the amount of other 401(k) Contributions made by the Participant for such Plan Year.

(c) Catch-Up Contributions will be elected in accordance with the procedures prescribed by the Administrator in Plan Rules.

(d) Catch-Up Contributions will be allocated to the Participant's 401(k) Contribution Account. Catch-Up Contributions are made to the profit sharing portion of the Plan. Any amounts invested in the Company Stock Fund are transferred from the profit sharing portion of the Plan to the stock bonus portion of the Plan and considered part of the Participant's ESOP Account.

3.3. ***Matching Contributions***.

(a) Subject to subsections (b), (e), (f) and (g) and the limitations described in Article 9, for any Plan Year a Participating Employer may, in its sole discretion, make Matching Contributions on behalf of each Active Participant. Matching Contributions may, as specified by the Participating Employer, be either (i) a dollar amount or (ii) a percentage of all or a portion of the 401(k) Contributions made by the Active Participant for the Plan Year (or any period within the Plan Year) following his or her entry into the Plan as a Participant for the purpose of sharing in Matching Contributions. If the Participating Employer decides to make a Matching Contribution for a Plan Year the Participating Employer will specify either (i) the dollar amount of the Matching Contribution (which may be different for eligible Active Participants who are Highly Compensated Employees and eligible Active Participants who are not) or (ii) the Matching Contribution percentage and the portion of an eligible Active Participant's 401(k) Contributions (and/or Catch-Up Contributions) to which the specified percentage applies (which may be different for eligible Active Participants who are Highly Compensated Employees and eligible Active Participants who are not). The Participating Employer will also specify the period (or periods) during such Plan Year to which the specified Matching Contribution relates.

(b) To be eligible to share in the Participating Employer's Matching Contribution made for a given payroll period a Participant must have, on or before the last day of the calendar quarter that includes such payroll period, entered the Plan as an

Active Participant for the purpose of having Matching Contributions made on his or her behalf, received Eligible Earnings for the payroll period from the Participating Employer, made 401(k) Contributions during the payroll period for which Matching Contributions are made and either:

(i) be employed with an Affiliated Organization as a Qualified Employee on either active status, on a paid leave of absence or on a leave of absence pursuant to the Family and Medical Leave Act of 1993 on the last day of the calendar quarter that includes such payroll period or

(ii) have terminated employment during the calendar quarter

(1) on or after attaining his or her Normal Retirement Age,

(2) on account of his or her death or

(3) on account of his or her becoming Disabled;

provided that this condition will be applied only once with respect to a Participant, such sole application being made for the Plan Year during which this clause (ii) first applies and the condition under clause (i) is not satisfied.

(c) Subject to subsections (e), (f) and (g) and the limitations described in Article 9, if, as of the end of a Plan Year, the aggregate amount of

Matching Contributions made on behalf of an Active Participant is less than the Matching Contributions specified under subsection (a) for the entire Plan Year, the Participating Employer may, in its sole discretion, make an additional Matching Contribution on behalf of each such Active Participant in an amount not exceeding the difference.

(d) A Participating Employer's Matching Contributions for a Plan Year (if any) will be paid to the Trustee on such date or dates during or following such Plan Year as the Participating Employer may elect but in no case more than 12 months after the end of the Plan Year. Except as allowed in Treasury Regulations, Matching Contributions will not be paid to the Trustee prior to the date the Active Participant performs the services with respect to which the Matching Contribution relates.

(e) No Matching Contribution will be made with respect to any portion of a Participant's 401(k) Contributions returned to the Participant pursuant to Article 9. For this purpose, 401(k) Contributions with respect to which no Matching Contributions are made for a Plan Year will be deemed to be the first such contributions returned to the Participant. If the Administrator determines that Matching Contributions that have been added to a Participant's Account should not have been added by reason of this subsection, the contributions, increased by Fund earnings or decreased by Fund losses attributable to the contributions, as determined under Section 9.3, will be subtracted from the Account as soon as administratively practicable after the determination is made and will be applied to satisfy the contribution obligations of the Participating

Employer that made the excess contributions for the Plan Year for which the excess contributions were made. If, because of the passage of time, the excess cannot be applied in this way, the excess will be allocated, in the discretion of the Administrator:

(i) among the Matching Contribution Accounts of all Participants who made 401(k) Contributions for the Plan Year as Qualified Employees of the Participating Employer in proportion to such 401(k) Contributions up to six percent of Eligible Earnings; or

(ii) as a corrective contribution pursuant to Section 3.6.

(f) Notwithstanding any other provision of this section to the contrary, a Participant covered by a collective bargaining agreement between his or her bargaining representative and a Participating Employer is eligible for Matching Contributions only if and to the extent provided in the collective bargaining agreement.

(g) Participating Employers will make Matching Contributions for each Plan Year on behalf of each Active Participant who makes a Catch-Up Contribution in accordance with the formula and provisions set forth in subsection (a).

(h) Matching Contributions are made to the profit sharing portion of the Plan; any amounts invested in the Company Stock Fund are transferred from the profit sharing portion of the Plan to the stock bonus portion of the Plan and considered part of the Participant's ESOP Account.

3.4. ***Profit Sharing Contributions.***

(a) Each Participating Employer may make a Profit Sharing Contribution for a Plan Year on behalf of eligible Participants for a Plan Year in an amount, if any, determined by the Participating Employer's Board, of his or her Eligible Earnings from the Participating Employer for the Plan Year.

(b) To be eligible to share in the Participating Employer's Profit Sharing Contribution, if any, for a particular Plan Year, a Participant must have, on or before the last day of the Plan Year, entered the Plan as a Participant for the purposes of having Profit Sharing Contributions made on his or her behalf, received Eligible Earnings for the Plan Year from the Participating Employer and either:

(i) be employed with an Affiliated Organization as a Qualified Employee on either active status, on a paid leave of absence or on a leave of absence pursuant to the Family and Medical Leave Act of 1993 on the last day of the Plan Year or

(ii) have terminated employment during the Plan Year

(1) on or after attaining his or her Normal Retirement Age,

(2) on account of his or her death or

(3) on account of his or her becoming Disabled;

provided that this condition will be applied only once with respect to a Participant, such sole application being made for the Plan Year during which this clause (ii) first applies and the condition under clause (i) is not satisfied.

(c) Subject to subsection (e) and the limitations of Article 9, a Participating Employer's Profit Sharing Contribution for a Plan Year (if any) will be allocated among the Profit Sharing Contribution Accounts of Participants. Each such Participant's allocated share of the contribution will bear the same ratio to the Participating Employer's total Profit Sharing Contribution for a Plan Year as the Participant's Eligible Earnings from the Participating Employer for the Plan Year bears to the aggregate Eligible Earnings from the Participating Employer for the Plan Year of all Participants who are eligible to share in the Participating Employer's Profit Sharing Contribution for the Plan Year.

(d) A Participating Employer's Profit Sharing Contribution for a Plan Year (if any) will be paid to the Trustee on such date or dates during or

following such Plan Year as the Participating Employer may elect but in no case more than 12 months after the end of the Plan Year.

(e) Notwithstanding any other provision of this section to the contrary, a Participant covered by a collective bargaining agreement between his or her bargaining representative and a Participating Employer is eligible to share in the Participating Employer's Profit Sharing Contribution only if and to the extent provided in the collective bargaining agreement.

(f) Profit Sharing Contributions are made to the profit sharing portion of the Plan; any amounts invested in the Company Stock Fund are transferred from the profit sharing portion of the Plan to the stock bonus portion of the Plan and considered part of the Participant's ESOP Account.

3.5. ***Rollovers***.

(a) A Participant may, with the prior consent of the Administrator, contribute to the Trust, within 60 days of receipt,

(i) an Eligible Rollover Distribution (excluding after-tax employee contributions) from a plan qualified under Code section 401(a), an annuity plan under Code section 403(b), an annuity contract under Code section 403(a), or an eligible deferred compensation plan under Code section 457(a) maintained by a governmental employer described in Code section 457 (e)(1)(A); or

(ii) the balance of an individual retirement account to which the only contributions have been one or more Eligible Rollover Distributions described in clause (i).

(b) Except as provided in subsection (d), any contribution to the Trust pursuant to subsection (a) must be made in cash. Any funds received by the Trust under this Section will be credited to the Participant's Rollover Account.

(c) Rollover contributions are made to the profit sharing portion of the Plan; any amounts invested in the Company Stock Fund are transferred from the profit sharing portion of the Plan to the stock bonus portion of the Plan and considered part of the Participant's ESOP Account.

(d) In the event that an Affiliated Organization acquires some or all of the assets or stock of another business organization, or engages in a similar transaction, the Administrator may, in its sole discretion, allow an individual who was employed by such business organization as of the closing date of such transaction and who is employed by a Participating Employer immediately thereafter as a Qualified Employee, to make all or a portion of any rollover contribution to the Trust pursuant to this Section 3.5 in the form of a promissory note evidencing a plan loan from a qualified retirement plan sponsored by such business organization, provided that:

(i) the Administrator has no reason to believe that the loan does not otherwise satisfy the requirements of Code section 72(p);

(ii) the Administrator has no reason to believe that an event of default with respect to the terms of the loan has occurred, or if such an event has occurred, the event of default was not corrected within the terms of the loan;

(iii) the promissory note will remain outstanding in accordance with the terms of the note, and those terms are not inconsistent with the administration of the Plan, or are subsequently revised to be consistent with the administration of the Plan;

(iv) the payee of the promissory note once it is rolled over into the Plan shall be the Trust;

(v) the payments of the rolled over promissory note will be credited to the Participant's Rollover Account; and

(vi) such plan loan will be subject to Plan Rules when it is rolled into the Plan.

3.6. ***Corrective Contributions***.

(a) For any Plan Year, a Participating Employer may, but is not required to, contribute on behalf of Active Participants who are not Highly Compensated Employees, or any group of such Participants identified by the Administrator, such amounts as the Participating Employer deems advisable to assist the Plan in satisfying the requirements of Section 9.2 or Section 9.3 or any other requirement under the Code or Treasury Regulations for the Plan Year.

(b) A Participating Employer may designate any contributions as "qualified nonelective contributions" or "qualified matching contributions" for purposes of satisfying the ADP test described in Section 9.2 or the ACP test described in Section 9.3 if the contributions meet all of the requirements of Treasury Regulation section 1.401(k)-2(a)(6). "Qualified matching contribution" means a matching contribution that is 100 percent vested when made and that may be withdrawn or distributed only under the conditions described in Treasury Regulation section 1.401(k)-1(d). "Qualified nonelective contribution" means a nonelective contribution that is 100 percent vested when made and that may be withdrawn or distributed only under the conditions described in Treasury Regulation section 1.401(k)-1(d).

(c) Contributions pursuant to this section will be allocated in accordance with one or more of the following clauses, as determined by the Administrator.

(i) Contributions are allocated among the Accounts of the Participants eligible to share in the allocation who made 401(k) Contributions

for the Plan Year in proportion to such 401(k) Contributions up to five percent of the Participant's Eligible Earnings for the Plan Year.

(ii) Contributions are allocated among the Accounts of the Participants eligible to share in the allocation in proportion to their respective Eligible Earnings from the Participating Employer for the Plan Year up to five percent of the Participant's Eligible Earnings for the Plan Year.

(iii) Contributions are allocated among the Accounts of Participants eligible to share in the allocation who made 401(k) Contributions for the Plan Year or allocated among the Accounts of the Participants eligible to share in the allocation for the Plan Year, (or both) by starting with the eligible Participant with the lowest Eligible Earnings for the Plan Year and allocating to that Participant up to the maximum amount taken into account in determining the ADP or ACP test and continuing successively with the eligible Participant(s) with the next lowest Eligible Earnings for the Plan Year until the amount to be allocated pursuant to this clause (iii) has been fully allocated.

(iv) Contributions are allocated among the Accounts of the Participants eligible to share in the allocation who made 401(k) Contributions for the

Plan Year or the Accounts of the Participants eligible to share in the allocation for the Plan Year, (or both) on a per capita basis.

(d) Contributions pursuant to this section which are used to satisfy the requirements of Sections 9.2 or 9.3 will be paid to the Trustee no later than 12 months after the end of the Plan Year to which such contributions relate (except as otherwise allowed under Treasury Regulations) and will be added to a separate sub-account with respect to which gains, losses, withdrawals and other credits or charges are separately allocated on a reasonable and consistent basis pursuant to Section 4.2.

(e) Corrective contributions made pursuant to this Section 3.6 are made to the profit sharing portion of the Plan. Any amounts invested in the Company Stock Fund are transferred from the profit sharing portion of the Plan to the stock bonus portion of the Plan and considered part of the Participant's ESOP Account.

ARTICLE 4.
ACCOUNTS AND VALUATION

4.1. ***Establishment of Accounts***.

(a) For each Participant, the following Accounts will be established and maintained:

(i) a 401(k) Contribution Account to which there will be added any 401(k) Contributions (including Catch-Up Contributions) made by the Participant;

(ii) a Matching Contribution Account, to which there will be added any Matching Contributions made on the Participant's behalf;

(iii) a Profit Sharing Contribution Account, to which there will be added any Profit Sharing Contributions made on the Participant's behalf; and

(iv) a Rollover Account, to which there will be added any rollover contribution made by the Participant pursuant to Section 3.5.

(b) To the extent that a Participant elects to invest any of the Participant's Accounts in the Company Stock Fund, such investment in the Company Stock Fund will be treated as invested in the ESOP portion of the Plan.

(c) One or more additional accounts or sub-accounts may be established and maintained for any Participant or group of similarly situated

Participants with respect to any contributions made pursuant to Section 3.6 or in connection with the merger of another plan into the Plan, in which case provisions of the Plan applicable solely to such accounts or sub-accounts will be set forth on an exhibit to the Plan in accordance with Section 14.1(f).

4.2. ***Valuation and Account Adjustment***. At such intervals as specified in Plan Rules, but at least annually, each Participant's Accounts within each investment fund established pursuant to Section 5.1 will be adjusted, in a manner determined by the Administrator to be uniform and equitable with respect to the Accounts being adjusted at the time in question, for income, expense, gains and losses of the investment fund, as well as contributions, withdrawals, loans, loan repayments, loan offsets, distributions and other activity, since the last prior adjustment.

4.3. ***Allocations Do Not Create Rights***. The fact that allocations are made and credited to the Accounts of a Participant does not vest in the Participant any right, title or interest in or to any portion of the Fund except at the time or times and upon the terms and conditions expressly set forth in the Plan. Notwithstanding any allocation or addition to the Account of any Participant, the issuance of any statement to the Participant or a Beneficiary of a deceased Participant or the distribution of all or a portion of any Account balance, the Administrator may direct the Account to be adjusted to the extent necessary to correct any error in the Account, whether caused by misapplication of any provision of the Plan or otherwise, and may recover from the Participant or Beneficiary the amount of any excess distribution.

ARTICLE 5.
PARTICIPANT INVESTMENT DIRECTION

5.1. ***Establishment of Investment Funds***.

(a) In order to allow each Participant to determine the manner in which his or her Accounts will be invested, the Trustee will maintain, within the Trust (i) three (3) or more separate investment funds of such nature and possessing such characteristics as the Investment Committee may specify from time to time and (ii) the Company Stock Fund. Each Participant's Accounts will be invested in the Company Stock Fund and other investment funds in the proportions directed by the Participant in accordance with the procedures set forth in this Article 5. The Investment Committee may, from time to time, direct the Trustee to establish additional investment funds or to terminate any existing investment fund (other than the Company Stock Fund).

(b) Notwithstanding any other provision of the Plan to the contrary, the Investment Committee may direct the Trustee to suspend Participant investment activity (including such activity in connection with withdrawals, loans and distributions) in any or all investment funds (other than the Company Stock Fund) or impose special rules or restrictions (other than with respect to the Company Stock Fund) of uniform application, for a period determined by the Investment Committee to be necessary in connection with:

(i) the establishment or termination of any investment fund;

(ii) the receipt by the Trustee from, or transfer by the Trustee to, another trust of account balances in connection with an acquisition or divestiture or otherwise;

(iii) a change of Trustee, investment manager or record keeper; or

(iv) such other circumstances determined by the Investment Committee as making such suspension or special rules or restrictions necessary or appropriate.

(c) Notwithstanding any other provision of the Plan to the contrary, the Administrator may direct the Trustee to temporarily suspend Participant investment activity (including such activity in connection with withdrawals, loans and distributions) in the Company Stock Fund or impose, temporarily, special rules or restrictions (with respect to the Company Stock Fund) of uniform application, for a period determined by the Administrator to be necessary in connection with:

(i) the receipt by the Trustee from, or transfer by the Trustee to, another trust of account balances in connection with an acquisition or divestiture or otherwise; or

(ii) a change of Trustee, investment manager or record keeper.

5.2. ***Contribution Investment Directions***.

(a) In conjunction with his or her enrollment in the Plan, a Participant must direct the manner in which contributions to his or her Accounts will be invested among the Company Stock Fund and/or other investment funds maintained pursuant to Section 5.1. Such a direction must be made in accordance with and is subject to Plan Rules. Notwithstanding the foregoing:

(i) the Accounts of a Participant who makes 401(k) Contributions pursuant to a deemed election under Section 3.1(b)(iii) will be invested in the manner specified in Plan Rules until such Participant makes an affirmative investment direction with respect to such Accounts; and

(ii) to the extent any Participant fails to direct Account investments, the Accounts will be invested in the manner specified in Plan Rules.

(b) A Participant may direct a change in the manner in which future contributions credited to his or her Accounts will be invested among the Company Stock Fund and/or other investment funds maintained pursuant to Section 5.1. Such a direction must be made in accordance with and is subject to Plan Rules and will become effective at the time and manner specified in Plan Rules and in accordance with rules and procedures of the Company Stock Fund and/or other investment funds after the Trustee receives a complete and accurate direction.

(c) Plan Rules will include procedures pursuant to which Participants are provided with the opportunity to obtain written confirmation of investment directions made pursuant to this section**.**

5.3. ***Transfer Among Investment Funds***.

(a) A Participant may direct the transfer of his or her Accounts among the Company Stock Fund and/or other investment funds maintained pursuant to Section 5.1. Such a direction must be made in accordance with and is subject to Plan Rules and will become effective at the time and manner specified in Plan Rules and in accordance with rules and procedures of the Company Stock Fund or other investment fund after the Trustee receives a complete and accurate direction.

(b) Plan Rules will include procedures pursuant to which Participants are provided with the opportunity to obtain written confirmation of investment directions made pursuant to this section.

(c) Plan Rules may limit and restrict transfers into and out of specific investment funds.

(d) Any transfer from the Company Stock Fund to another investment fund will constitute a transfer out of the ESOP portion of the Plan.

5.4. ***Investment Direction Responsibility Resides With Participants***. The Plan is intended to constitute a plan described in ERISA section 404(c). Accordingly, the Administrator, the Investment Committee, the Trustee, the Company and the Participating Employers do not have any authority, discretion, responsibility or liability with respect to a Participant's selection of the investment funds (including the Company Stock Fund and the Plan's other investment funds) in which his or her Accounts will be invested, the entire authority, discretion and responsibility for, and any results attributable to, the selection being that of the Participant.

5.5. ***Company Stock Restrictions***. In the event that the shares of Company common stock allocated to an Account of a Participant are not readily tradeable on an established market, then a Participant who is entitled to a distribution from the Plan will have the right to require that the Company repurchase such shares under a fair valuation formula. A Participant's right to exercise the "put option" described above shall exist only in a Plan Year in which shares of Company common stock are not readily tradeable on an established securities market. In such a Plan Year, the "put option" shall be provided for periods that meet the requirements of section 409(h)(4) of the Code, and, if exercised, shall result in payments that meet the requirements of section 409(h)(5) or 409(h)(6) of the Code, if applicable.

5.6. ***Voting of Company Stock***

(a) Each Participant and Beneficiary whose Account is invested in the Company Stock Fund will be afforded the opportunity to direct the manner in which shares of Company common stock in the Company Stock Fund allocated to his or her Account will be voted in connection with all stockholder actions of the Company. In the event of a public tender or exchange offer for shares of common stock of the Company, each Participant and Beneficiary will be entitled to direct whether or not the shares in the Company Stock Fund allocated to his or her Account will be tendered for sale or exchange in connection with such offer.

(b) The Administrator will, prior to each meeting of Company stockholders, cause to be furnished to each such Participant and Beneficiary a copy of any proxy solicitation material prepared by the Company, together with a form requesting confidential directions on how the shares of Company stock allocable to the Participant's or Beneficiary's Account will be voted on each matter to be brought before such meeting. The Administrator will use his or her best efforts to ensure that each Participant and Beneficiary receives such information as will be distributed to stockholders of the Company in connection with any public tender or exchange offer for shares of Company common stock and that each receives instructions for giving confidential directions to the Trustee.

(c) The Trustee or its delegate will hold all directions received from Participants and Beneficiaries pursuant to this Section 5.6 in strict confidence and will not disclose any such direction to any person, including any officer or employee of the Company or of an Affiliated Organization, except as may be required to allow an independent inspector of elections to certify voting results or to satisfy the

requirements of law.

(d) The Trustee or its delegate will vote the number of full and fractional shares allocable to each Participant's and each Beneficiary's Account as directed by the Participant or Beneficiary if the direction is received in time for the direction to be processed. The Trustee will vote any Company stock with respect to which it does not receive timely directions so that the proportion of such stock voted in any particular manner on any matter is the same as the proportion of the stock with respect to which the Trustee has received timely directions which is so voted.

(e) In the case of a public tender or exchange offer, the Trustee will tender the shares attributable to a Participant's or Beneficiary's Account if so directed by the Participant or Beneficiary, and will not tender shares attributable to the Account of a Participant or Beneficiary who either directs that such shares not be tendered or does not furnish a timely direction. Any proceeds from a tender of Company common stock will be

allocated among the Accounts of the Participants and Beneficiaries to which the tendered stock was allocated. Such proceeds will be held in a sub-account of the Company Stock Fund and invested in the manner prescribed by Plan Rules.

(f) Solely for purposes of this Section 5.6, each Participant and Beneficiary is designated as a "named fiduciary" within the meaning of section 403(a)(1) of ERISA. Each Participant's or Beneficiary's direction will apply to the number of shares in the Company Stock Fund that are allocable to such Participant or Beneficiary.

5.7. ***Default Investments***

(a) If a Participant or Beneficiary fails to give instructions with respect to the investment of his or her Accounts in connection with a change in the Trustee or other termination of an investment fund in which the Accounts are invested, the Accounts will be invested in the investment fund or funds then available under the Plan that the Administrator determines to have investment characteristics most similar to the fund or funds in which the Accounts were previously invested.

(b) If a Participant or Beneficiary fails to give instructions with respect to the investment of a contribution to his or her Accounts or of the proceeds from a tender of Company stock, the contribution or proceeds will be invested in the fund specified by Plan Rules.

5.8. ***Beneficiaries and Alternate Payees***. Solely for purposes of this article, the term "Participant" includes the Beneficiary of a deceased Participant and an alternate payee under a qualified domestic relations order within the meaning of Code section 414(p) unless otherwise provided in such order, but only after:

(a) the Administrator has determined the identity of the Beneficiary and the amount of the Account balance to which he or she is entitled in the case of a Beneficiary of a deceased Participant; or

(b) the Administrator has, in accordance with Plan Rules, made a final determination that the order is a qualified domestic relations order and all rights to contest such determination in a court of competent jurisdiction within the time prescribed by Plan Rules have expired or been exhausted in the case of an alternate payee.

ARTICLE 6.
WITHDRAWALS DURING EMPLOYMENT, PLAN LOANS AND ESOP DIVIDEND DISTRIBUTIONS

6.1. ***Hardship Withdrawals from 401(k) Contribution Account and Matching Contribution Account***.

(a) Subject to the provisions of Section 6.4, a Participant who is an Employee may make a hardship withdrawal from his or her 401(k) Contribution Account and vested portion of his or her Matching Contribution Account (other than a sub-account described in Section 3.6) in accordance with this section. A hardship withdrawal will be permitted only if the Administrator determines that the withdrawal is made on account of an immediate and heavy financial need of the Participant and is necessary to satisfy such financial need.

(b) A withdrawal will be deemed to be made on account of an immediate and heavy financial need only if it is determined by the Administrator to

be on account of:

(i) expenses for (or necessary to obtain) medical care that would be deductible by the Participant under Code section 213(d) (determined without regard to whether the expenses exceed 7.5% of adjusted gross income);

(ii) costs directly related to the purchase (excluding mortgage payments) of a principal residence of the Participant;

(iii) payment of tuition, related educational fees and room and board expenses for the next 12 months of post-secondary education for the Participant or his or her spouse, child or other dependent (as defined in Code section 152, without regard to Code sections 152(b)(1), (b)(2) and (d)(1)(B));

(iv) payments necessary to prevent the eviction of the Participant from his or her principal residence or foreclosure on the mortgage on the Participant's principal residence;

(v) payments for burial or funeral expenses of the Participant's deceased parent, spouse, child or dependent (as defined in Code section 152, without regard to Code sections 152(b)(1), (b)(2) and (d)(1)(B));

(vi) expenses for the repair of damage to the Participant's principal residence that would qualify as a casualty deduction under Code section 165 (but determined without regard to whether the expenses exceed 10% of the Participant's adjusted gross income); or

(vii) any other deemed hardship recognized under Code section 401(k).

(c) A withdrawal will be deemed to be necessary to satisfy the immediate and heavy financial need of the Participant only if the Administrator determines that each of the requirements in this subsection is satisfied.

(i) The withdrawal is not more than the sum of the amount of the immediate and heavy financial need of the Participant plus an amount to pay any federal, state or local taxes or penalties that the Participant will incur in connection with the withdrawal or to satisfy withholding obligations in connection with that withdrawal, in either case as determined by the Administrator in accordance with Plan Rules.

(ii) The Participant has obtained all other currently available distributions (including distribution of ESOP dividends under section 404(k), but not hardship distributions) and nontaxable (at the time of the loan) loans under the Plan and all other qualified and non-qualified plans of deferred compensation maintained by any Affiliated Organization.

(iii) The Participant must, at the time of the application for the hardship withdrawal, have on file an election to receive a distribution of dividends paid on Company common stock held in the Company Stock Fund allocable to such Participant's Accounts.

(iv) The Participant is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making 401(k) Contributions or other elective contributions and employee contributions to this Plan and "all other plans maintained by any Affiliated Organization" for six months after receipt of the hardship withdrawal. For purposes of this paragraph (c)(iv), the phrase "all other plans maintained by any Affiliated Organization" means all qualified and nonqualified plans of deferred compensation, stock option, stock purchase or similar plan maintained by an Affiliated Organization, including a cash or deferred arrangement that is part of a cafeteria plan within the meaning of Code section 125; provided, it does not include the mandatory employee contribution portion of a defined benefit plan or a health or welfare benefit plan (including one that is part of a cafeteria plan).

(d) The Administrator's determination of the existence of a Participant's financial hardship and the amount that may be withdrawn to satisfy the need created by such hardship will be made in accordance with Treasury Regulations, and is final and binding on the Participant. The Administrator may require the Participant to make representations and certifications concerning his or her entitlement to a withdrawal pursuant to this section and is entitled to rely on such representations and certifications unless the Administrator has actual knowledge to the contrary. The Administrator is not obligated to supervise or otherwise verify that amounts withdrawn are applied in the manner specified in the Participant's withdrawal application.

(e) The amount of any withdrawal pursuant to this Section may not exceed the Participant's vested portion of his or her Matching Contribution Account and amount of 401(k) Contributions made by the Participant and reduced by the amount of 401(k) Contributions previously distributed to the Participant. The withdrawal will be made first from the Participant's vested portion of his or her Matching Contribution Account and then from his or her 401(k) Contributions.

6.2. ***Withdrawals from 401(k) Contribution Account and Matching Contribution Account After Attaining Age 59½***. Subject to the provisions of Section 6.4, a Participant who (a) is an Employee and (b) has attained age 59½ may withdraw all or any part of the balance of his or her 401(k) Contribution Account and the vested portion of his or her Matching Contribution Account.

6.3. ***Withdrawals from Rollover Account***. Subject to the provisions of Section 6.4, a Participant who is an Employee may withdraw all or any part of the balance of his or her Rollover Account.

6.4. ***Rules for Withdrawals***.

(a) Applications for withdrawals must be made in accordance with and are subject to Plan Rules.

(b) A withdrawal will be made as soon as administratively practicable after the Administrator's determination that the Participant is entitled to receive the withdrawal.

(c) A withdrawal will be made on a pro rata basis from the investment fund or funds in which the Account from which the withdrawal is made is invested.

(d) Withdrawals may be in the form of cash or whole shares of Company common stock to the extent the withdrawal is from the Participant's ESOP Account.

(e) All withdrawals will be made in the form of a single sum payment made by a check drawn on the Trust.

(f) A Participant may not withdraw the portion of his or her Accounts consisting of a note evidencing the unpaid balance of any loan made pursuant to the Plan.

(g) The provisions of Section 8.8 apply to any withdrawal that constitutes an Eligible Rollover Distribution.

6.5. ***No Other In-Service Withdrawals***. Except as otherwise expressly provided in the Plan, a Participant may not make withdrawals from his or her Accounts prior to his or her Severance from Employment.

6.6. ***Plan Loans***.

(a) Each Participant or Beneficiary of a deceased Participant who is an Employee or is otherwise a "party in interest" within the meaning of ERISA, may borrow funds from the vested balance of his or her Accounts by submitting to the Administrator a complete and accurate loan application, in accordance with and subject to Plan Rules, subject to the succeeding provisions of this section.

(i) The amount of the loan may not cause the aggregate amount of outstanding loans to the borrower from the Plan to exceed the least of:

(1) $50,000, reduced by the excess (if any) of (A) the highest outstanding balance of all loans to the borrower from the Plan and all other qualified plans maintained by any Affiliated Organization during the 12-month period ending on the day before the date of the loan over (B) the outstanding balance of such loans on the date of the loan; and

(2) 50% of the aggregate vested balance of the borrower's Accounts as of the date on which the loan is made.

(ii) The maturity date for any loan may not exceed five (5) years from the date of the note, unless the Administrator determines at the time the loan is made that the proceeds of the loan will be used to purchase a house, townhome, apartment, condominium or mobile home used, or intended to be used within a reasonable time after the loan is made, as the borrower's principal residence, in which case the maturity date may not exceed fifteen (15) years from the date of the note.

(iii) Loans will be charged against a Participant's Accounts on a pro rata basis. No loan will be charged against any Account until the funds available to be borrowed in any prior Account have been exhausted. A loan application fee, if any, charged by the Trustee or another third party will be charged against the Participant's Accounts in the same order.

(iv) The loan proceeds and any loan application fee will be obtained from the investment fund or funds in which the borrower's Accounts are then invested on a pro rata basis.

(v) The promissory note evidencing a loan must provide for payments of principal and interest in equal installments of such frequency, not less frequently than quarterly, in such minimum amounts and for such maximum period as Plan Rules prescribe.

(b) Each loan will be a loan by the Trust, but for Trust accounting purposes the loan will be deemed made from the borrower's Accounts against which the loan is charged, and the note executed by the borrower will be deemed to be an asset of those Accounts. When a loan is made, the borrower's Accounts and any

investment fund from which the loan proceeds are obtained will be reduced by an amount equal to the principal balance of the loan and a loan account will be established for the borrower with an initial balance equal to the principal amount of the loan. The loan account will be excluded for purposes of determining and allocating the net earnings (or losses) of the Trust pursuant to Section 4.2. A borrower's loan payments will be credited to the Accounts from which the loan proceeds were obtained on a pro rata basis. The loan account will be reduced by the amount of any principal payment on the loan. Repayments of loan principal and payments of interest will be invested as soon as administratively practicable following receipt by the Trustee in accordance with the borrower's most recent investment directions with respect to new contributions or in the absence of such a direction, in accordance with Plan Rules.

(c) Plan Rules may specify other terms and conditions as may be necessary or desirable for the administration of loans under this section.

6.7. ***ESOP Dividend Distributions.***

(a) Each Participant may elect, in the manner prescribed by the Administrator, whether to receive from the ESOP the dividends paid by the Company on Company common stock held in the Company Stock Fund allocable to the vested portion of such Participant's Accounts. A Participant who fails to make an election will be deemed to have elected not to receive distribution of such dividends; provided that a Participant who files an application to receive a hardship withdrawal pursuant to Section 6.1 will be deemed to have made an election, as of the date of such application, to receive distribution of such dividend.

(b) A Participant's election will be effective with respect to all dividends paid to the ESOP after the date of the election until a new election takes effect. A Participant may make a new election at any time except during the blackout period designated by the Administrator before and after the date the Company stock dividend is paid.

(c) The amount of dividends received by the ESOP for a calendar quarter that a Participant has elected to receive will be paid to the Participant in a single lump sum payment following the dividend payment of such calendar quarter, and in all events not later than ninety (90) days after the close of such calendar quarter. Notwithstanding the Participant's election, if the amount the Participant would receive for a calendar quarter is less than the minimum dividend distribution amount (if any) specified by Plan Rules, the Participant will be deemed to have elected not to receive distribution of any dividends for such calendar quarter.

(d) To the extent that a Participant does not elect to receive a distribution of dividends paid with respect to the Participant's ESOP Account, the dividends so paid shall be credited to the Participant's ESOP Account and reinvested in the Company Stock Fund.

(e) A Participant's election to receive distribution of dividends paid with respect to the Participant's ESOP Account will become irrevocable with respect to a Company stock dividend at the time of the election blackout period preceding the dividend payment. Any distribution made to the Participant following the date an election has become irrevocable will, to the extent it includes dividends to which the election applied, be deemed to constitute a distribution of such dividends. Such distribution of dividends will not be an Eligible Rollover Distribution.

ARTICLE 7.
VESTING AND FORFEITURES

7.1. ***Vesting***.

(a) A Participant always has a fully vested non-forfeitable interest in his or her 401(k) Contribution Account, Rollover Account and in the sub-account described in Section 3.6(d).

(b) A Participant will acquire a fully vested non-forfeitable interest in his or her Matching Contribution Account and Profit Sharing Contribution Account upon attaining Normal Retirement Age while he or she is, or before he or she became, an Employee.

(c) A Participant will acquire a fully vested non-forfeitable interest in his or her Matching Contribution Account and Profit Sharing Contribution Account if he or she dies or becomes Disabled while he or she is an Employee.

(d) A Participant who has a Severance from Employment prior to attaining Normal Retirement Age other than by reason of his or her death or becoming Disabled will acquire a vested non-forfeitable interest in his or her Matching Contribution Account and Profit Sharing Contribution Account to the extent provided in the following schedule.

Full Years of Vesting Service	Vested Interest
Less Than 1 Year	0 %
1 Year	25%
2 Years	50%
3 Years	75%
4 or More Years	100%

7.2. ***Forfeiture Upon Distribution***.

(a) If a Participant receives a distribution of the entire vested balance of his or her Accounts after Severance from Employment and before he or she incurs five consecutive One-Year Breaks in Service, the nonvested portions of the Participant's Matching Contribution Account and Profit Sharing Contribution Account will, at the time of such distribution, be forfeited. A Participant who has no vested interest in his or her Accounts when he or she terminates employment will be deemed to have received a distribution of the entire vested balance of the Accounts at the time of his or her Severance from Employment.

(b) If a Participant described in subsection (a) received a distribution of less than the entire balance of his or her Accounts, resumes employment as a Qualified Employee and repays to the Trustee the full amount distributed, other than the portion of the distribution attributable to his or her Rollover Account balance, before the earlier of (1) five (5) years following the date of reemployment as a Qualified Employee or (2) the date on which he or she incurs five (5) consecutive One-Year Breaks in Service following the distribution, then, the amount of any forfeitures will be restored to the Participant's Matching Contribution Account and Profit Sharing Contribution Account, unadjusted for interest or any change in value occurring after the distribution. Such restoration will be made from forfeitures that arise for the Plan Year for which such restoration is to be made. To the extent such forfeitures are insufficient for such purpose, the Participating Employer with whom the Participant was last employed as a Qualified Employee will contribute the amount required to restore the Accounts. A Participant described in the last sentence of subsection (a) who is reemployed before incurring five (5) consecutive One-Year Breaks in Service following the date of his or her Severance from Employment will be deemed to have repaid his or her deemed distribution upon his or her reemployment as a Qualified Employee.

7.3. ***Other Forfeitures***.

(a) Except as provided in Section 7.2, the non-vested portions of a Participant's Matching Contribution Account and Profit Sharing Contribution Account will continue to be held in separate sub-accounts of such Accounts until the Participant incurs five (5) consecutive One-Year Breaks in Service, at which time the sub-account balances will be forfeited. If the Participant resumes employment with an Affiliated Organization prior to incurring five (5) consecutive One-Year Breaks in Service, such sub-accounts will be disregarded and their balances will be included in the Matching Contribution Account and Profit Sharing Contribution Account.

(b) A Participant's vested interest in his or her Matching Contribution Account and Profit Sharing Contribution Account balances following a resumption of employment in accordance with subsection (a) at any given time will not be less than the amount "X" determined by the formula: X = P(AB + (R x D)) - (R x D), where P is the Participant's vested percentage at the time of determination; AB is the Account balance at the time of determination; D is the amount of the distribution; and R is the ratio of the Account balance at the time of determination, to the sub-account balance immediately following the distribution.

7.4. ***Application of Forfeitures***. All forfeitures occurring in a Plan Year will be allocated to an account, invested in accordance with Plan Rules and applied as follows:

(a) such forfeitures will first be applied to restore the Accounts of Participants as provided in Sections 7.2(b) and 8.7;

(b) at the direction of the Administrator, any remaining forfeitures may be used to pay expenses of administering the Plan;

(c) any remaining forfeitures may be applied toward the amount of Matching Contributions by the Participating Employers for the Plan Year in which the forfeiture occurs; and

(d) any remaining forfeitures may be applied toward the amount of Profit Sharing Contributions by the Participating Employers for the Plan Year in which the forfeiture occurs.

ARTICLE 8.

DISTRIBUTIONS AFTER SEVERANCE FROM EMPLOYMENT

8.1. ***Form and Time of Distribution***.

(a) Following a Participant's Severance from Employment, the Trustee will distribute to the Participant or, if the Participant has died, to his or her Beneficiary, the value of the Participant's vested interest in his or her Accounts. Subject to the remaining subsections of this section, Section 8.2 and Section 8.8, distributions will be made in accordance with the following provisions.

(i) If the aggregate balance of the Participant's vested interest in his or her Accounts (excluding the balance of the Participant's Rollover Account, if any) is not more than $5,000, distribution to the Participant (or to the Participant's Beneficiary in the case of the Participant's death) will be made as soon as administratively practicable following the Participant's Severance from Employment; provided, that if the aggregate balance of the Participant's vested interest in his or her Accounts (including the balance of the Participant's Rollover Account, if any) exceeds $1,000 and the Participant does not elect another form of distribution, the Participant's vested interest in such Accounts will, following notice to the Participant, be distributed as a direct rollover to an Individual Retirement Account selected by the Administrator in accordance with Code section 401(a)(31)(B).

(ii) Except as provided in clause (i), distribution to the Participant will be made in the form of a lump sum payment, installment payments or non-periodic payments or a combination of installment payments and non-periodic payments, as elected by the Participant. The distribution will be made or will begin, as the case may be, as soon as administratively practicable after the Administrator receives the Participant's properly completed distribution request, but in no case later than the sixtieth day after the Plan Year during which the Participant has a Severance from Employment or attains Normal Retirement Age, whichever is later, unless the Participant elects to defer the distribution pursuant to subsection (b).

(iii) Except as provided in clause (i) and Section 8.2, distribution to the Participant's Beneficiary following the Participant's death will be made at the time elected by the Beneficiary in accordance with subsection (d).

(iv) Involuntary lump sum payments made pursuant to Section 8.1(a)(i) (because the Participant or Beneficiary had not already elected to receive a distribution) will be made in the form of a single cash payment (or, if applicable, direct rollover to an Individual Retirement Account) and all installment payments will be made in the form of cash payments. With respect to any other distribution under the Plan, to the extent the Participant's Account is invested in the Company Stock Fund, distribution

will be made in shares of Company common stock or cash, whichever the Participant or Beneficiary, as the case may be, elects; provided that, first, only a whole number of shares may be distributed in kind and the balance of any distribution will be paid in cash; and second, if the Participant or Beneficiary does not make an election, any distribution will be made in cash. Distribution may also be made, if applicable, in the form of a canceled note evidencing any Plan loan.

(v) If a contribution is allocated to a Participant's Account following the Participant's Severance from Employment and after his or her vested Account balance has been distributed, as soon as administratively practicable after the allocation is made, the vested portion of the contribution will be distributed to the Participant, or to the Participant's Beneficiary in the case of the Participant's death, in the form of a lump sum cash payment or, if distribution is being made in the form of installment payments, applied to increase the amount of such payments.

(b) Subject to the provisions of the other subsections of this section, a Participant described in subsection (a)(ii) may elect to defer commencement of his or her distribution under the Plan as of a specified date that is no later than the Participant's required beginning date described in Section 8.2(b)(i) by providing the Administrator with a written, signed statement specifying the date on which the payment is to be made; provided that if a Participant fails to consent to a distribution, the Participant shall be deemed to have elected to defer distribution of his or her benefits until the Participant's required beginning date described in Section 8.2(b)(i). Plan Rules may permit a Participant to modify the election in any manner determined by the Administrator to be consistent with Code section 401(a)(14) and the other provisions of this section.

(c) If a Participant described in subsection (a)(ii) elects to receive his or her distribution in the form of monthly, quarterly, semi-annual or annual

installment payments, the payments will be made for a period not longer than either the Participant's life expectancy or the life expectancy of the Participant and his or her Beneficiary, as elected by the Participant in accordance with and subject to Plan Rules. Subject to the foregoing, (1) installment payments may be substantially equal in amount or may be in unequal amounts, as elected by the Participant in accordance with and subject to Plan Rules, (2) not more than once each Plan Year, the Participant may elect, in accordance with and subject to Plan Rules, to change the amount of installment payments made after the effective date of the election and (3) the Participant may, from time to time, elect, in accordance with and subject to Plan Rules, to receive an additional single sum payment of not more than the vested balance of his or her Accounts. Except as otherwise provided in Plan Rules, distributions pursuant to this subsection will be made from the Participant's Accounts and the investment fund or funds in which the Accounts are then invested on a pro rata basis.

(d) Subject to subsection (a)(i) and Section 8.2, the Participant's Accounts will be distributed in a single lump sum payment to his or her Beneficiaries as of the end of the calendar month coincident with or immediately following (or as soon as administratively practicable thereafter) his or her death; provided, that the Beneficiary or Beneficiaries may elect to have such distribution made to him or her or them, as the case may be, in monthly, quarterly, semi-annual or annual installment payments. If distribution is made in the form of installment payments, in no event may the aggregate amount of such installment payments for a Plan Year be less than the amount of earnings credited to the Accounts during that Plan Year.

(e) In lieu of making installment payments to a Participant or Beneficiary directly from the Trust, the Administrator may use the vested balance of the Participant's or Beneficiary's Accounts to purchase an annuity contract from an insurance company and distribute the contract to the Participant or Beneficiary.

8.2. ***Required Minimum Distributions***

(a) General Rules.

(i) *Precedence*. The requirements of this Section 8.2 will take precedence over any inconsistent provisions of the Plan; provided, however, that this Section 8.2 will not require the Plan to provide any form of benefit, or any option, not otherwise provided under the Plan.

(ii) *Requirements of Treasury Regulations Incorporated*. All distributions required under this section will be determined and made in accordance with the Treasury Regulations under Code section 401(a)(9).

(b) Time and Manner of Distribution.

(i) *Required Beginning Date*. The Participant's entire interest will be distributed, or begin to be distributed, to the Participant no later than April 1st of the calendar year following the later of either the calendar year in which the Participant attains age seventy and one-half (70½) or during which occurs the Participant's Severance from Employment. Distribution to any Participant who is a "five percent owner," within the meaning of the Code section 416, must begin not later than April 1st of the calendar year following the calendar year during which the Participant attains age 70½.

(ii) *Death of Participant Before Distributions Begin*. Subject to Section 8.1(a)(i), if the Participant dies before distributions begin, the Participant's entire interest will be distributed, or begin to be distributed, no later than as follows.

(1) If the Participant's surviving spouse is the Participant's sole designated Beneficiary, then distributions to the surviving spouse

will begin by December 31 of the calendar year immediately following the calendar year in which the Participant died, or by December 31 of the calendar year in which the Participant would have attained age 70½, if later.

(2) If the Participant's surviving spouse is not the Participant's sole designated Beneficiary, then the Participant's entire interest will be distributed as follows:

(A) if the designated Beneficiary elects to receive distributions under the life expectancy rule pursuant to Section 8.2(e), distributions to the designated Beneficiary will begin by December 31 of the calendar year immediately following the calendar year in which the Participant died; or

(B) if the designated Beneficiary has not made an election to receive distributions under the life expectancy rule pursuant to Section 8.2(e), the Participant's entire interest will be distributed by December 31 of the calendar year containing the fifth anniversary of the Participant's death.

(3) If there is no designated Beneficiary as of September 30 of the year following the year of the Participant's death, the Participant's entire interest will be distributed by December 31 of the calendar year containing the fifth anniversary of the Participant's death.

(4) If the Participant's surviving spouse is the Participant's sole designated Beneficiary and the surviving spouse dies after the Participant but before distributions to the surviving spouse begin, the surviving spouse's entire interest will be distributed to

the surviving spouse's estate by December 31 of the calendar year containing the fifth anniversary of the surviving spouse's death.

(5) If the Participant's surviving spouse is not the Participant's sole designated Beneficiary and the designated Beneficiary dies after the Participant but before distributions to the designated Beneficiary begin, the designated Beneficiary's entire interest will be distributed to the designated Beneficiary's estate by December 31 of the calendar year containing the fifth anniversary of the Participant's death.

For purposes of this Section 8.2(b)(ii) and Section 8.2(d), unless paragraph (4) above applies, distributions are considered to begin on the Participant's required beginning date. If paragraph (4) applies, distributions are considered to begin on the date distributions are required to begin to the surviving spouse under paragraph (1) above.

(iii) *Forms of Distribution.* Unless the Participant's interest is distributed in a single sum on or before the required beginning date, as of the first distribution calendar year, distributions will be made in accordance with Sections 8.2(c) and (d).

(c) Required Minimum Distributions During Participant's Lifetime.

(i) *Amount of Required Minimum Distribution For Each Distribution Calendar Year*. During the Participant's lifetime, the minimum amount that will be distributed for each distribution calendar year is the lesser of:

(1) the quotient obtained by dividing the Participant's account balance by the distribution period in the Uniform Lifetime Table set forth in Section 1.401(a)(9)-9 of the Treasury Regulations, using the Participant's age as of the Participant's birthday in the distribution calendar year; or

(2) if the Participant's sole designated Beneficiary for the distribution calendar year is the Participant's spouse, the quotient obtained by dividing the Participant's account balance by the number in the Joint and Last Survivor Table set forth in Section 1.401(a)(9)-9 of the Treasury Regulations, using the Participant's and spouse's attained ages as of the Participant's and spouse's birthdays in the distribution calendar year.

(ii) *Lifetime Required Minimum Distributions Continue Through Year of Participant's Death.* Required minimum distributions will be determined under this Section 8.2(c) beginning with the first distribution calendar year and up to and including the distribution calendar year that includes the Participant's date of death.

(d) Required Minimum Distributions After Participant's Death.

(i) *Death On or After Date Distributions Begin.*

(1) *Participant Survived by Designated Beneficiary.* If the Participant dies on or after the date distributions begin and there is a designated Beneficiary, the minimum amount that will be distributed for each distribution calendar year after the year of the Participant's death is the quotient obtained by dividing the Participant's account balance by the longer of the remaining life expectancy of the Participant or the remaining life expectancy of the Participant's designated Beneficiary, determined as follows.

(A) The Participant's remaining life expectancy is calculated using the age of the Participant in the year of death, reduced by one for each subsequent year.

(B) If the Participant's surviving spouse is the Participant's sole designated Beneficiary, the remaining life expectancy of the surviving spouse is calculated for each distribution calendar year after the year of the Participant's death using the surviving spouse's age as of the spouse's birthday in that year. For distribution calendar years after the year of the surviving spouse's death, the remaining life expectancy of the surviving spouse is calculated using the age of the surviving spouse as of the spouse's birthday in the calendar year of the spouse's death, reduced by one for each subsequent calendar year.

(C) If the Participant's surviving spouse is not the Participant's sole designated Beneficiary, the designated Beneficiary's remaining life expectancy is calculated using the age of the Beneficiary in the year following the year of the Participant's death, reduced by one for each subsequent year. For distribution calendar years after the year of the designated Beneficiary's death, the remaining life expectancy of the designated Beneficiary is calculated using the age of the designated Beneficiary as of the designated Beneficiary's birthday in the calendar year of the designated Beneficiary's death, reduced by one for each subsequent calendar year.

(2) *Acceleration of Payment to Designated Beneficiary*. The designated Beneficiary may elect at any time to accelerate any remaining payments and receive a single lump sum distribution.

(3) *No Designated Beneficiary*. If the Participant dies on or after the date distributions begin and there is no designated Beneficiary as of September 30 of the year after the year of the Participant's death, the minimum amount that will be

distributed for each distribution calendar year after the year of the Participant's death is the quotient obtained by dividing the Participant's account balance by the Participant's remaining life expectancy calculated using the age of the Participant in the year of death, reduced by one for each subsequent year.

(ii) *Death Before Date Distributions Begin*.

(1) *Participant Survived by Designated Beneficiary*. If the Participant dies before the date distributions begin and there is a designated Beneficiary, and the designated Beneficiary elects to receive distributions over his or her life expectancy, the minimum amount that will be distributed for each distribution calendar year after the year of the Participant's death is the quotient obtained by dividing

the Participant's account balance by the remaining life expectancy of the Participant's designated Beneficiary, determined as provided in Section 8.2(d)(i).

(2) *No Designated Beneficiary*. If the Participant dies before the date distributions begin and there is no designated Beneficiary as of September 30 of the year following the year of the Participant's death, distribution of the Participant's entire interest will be completed by December 31 of the calendar year containing the fifth anniversary of the Participant's death.

(3) *Death of Surviving Spouse Before Distributions to Surviving Spouse Are Required to Begin.* If the Participant dies before the date distributions begin, the Participant's surviving spouse is the Participant's sole designated Beneficiary, and the surviving spouse dies before distributions are required to begin to the surviving spouse under Section 8.2(b)(ii)(1), the surviving spouse's entire interest will be distributed to the surviving spouse's estate by December 31 of the calendar year containing the fifth anniversary of the surviving spouse's death.

(4) *Death of Designated Beneficiary Before Distributions to Designated Beneficiary Are Required to Begin.* If the Participant dies before the date distributions begin, the Participant's surviving spouse is not the Participant's sole designated Beneficiary, and the designated Beneficiary dies before distributions are required to begin to the designated Beneficiary under Section 8.2(b)(ii)(2), the designated Beneficiary's entire interest will be distributed to the designated Beneficiary's estate by December 31 of the calendar year containing the fifth anniversary of the Participant's death.

(e) Beneficiary Election of 5-Year Rule or Life Expectancy Rule.

(i) *General Rule*. Beneficiaries may elect on an individual basis whether the 5-year rule or the life expectancy rule in Section 8.2(b)(ii)(2) and Section 8.2(d)(ii)(1) applies to distributions after the death of a Participant who has a designated Beneficiary. The election must be made no later than December 31 of the calendar year immediately following the calendar year in which the Participant died. If the Beneficiary does not make an election under this paragraph, distributions will be made in accordance with Section 8.2(b)(ii)(2)(B).

(ii) *Transition Rule*. A designated Beneficiary who is receiving payments under the 5-year rule may make a new election to receive payments under the life expectancy rule until December 31, 2003, provided that all amounts that would have been required to be distributed under the life expectancy rule for all distribution calendar years before 2004 are

distributed by the earlier of December 31, 2003 or the end of the 5-year period.

(f) Definitions.

(i) *Designated Beneficiary*. The designated Beneficiary is the individual who is designated as the Beneficiary under Section 8.2 of the Plan and is the designated Beneficiary under Code section 401(a)(9) and Section 1.401(a)(9)-4, Q&A-1, of the Treasury Regulations.

(ii) *Distribution calendar year*. A distribution calendar year is a calendar year for which a minimum distribution is required. For distributions beginning before the Participant's death, the first distribution calendar year is the calendar year immediately preceding the calendar year which contains the Participant's required beginning date. For distributions beginning after the Participant's death, the first distribution calendar year is the calendar year in which distributions are required to begin under Section 8.2(b). The required minimum distribution for the Participant's first distribution calendar year will be made on or before the Participant's required beginning date. The required minimum distribution for other distribution calendar years, including the required minimum distribution for the distribution calendar year in which the Participant's required beginning date occurs, will be made on or before December 31 of that distribution calendar year.

(iii) *Life expectancy*. Life expectancy is computed by use of the Single Life Table in Section 1.401(a)(9)-9 of the Treasury Regulations.

(iv) *Participant's Account balance*. The Participant's Account balance is the balance as of the last valuation date in the calendar year immediately preceding the distribution calendar year (valuation calendar year) increased by the amount of any contributions made and allocated or forfeitures allocated to the Account balance as of dates in the valuation calendar year after the valuation date and decreased by distributions made in the valuation calendar year after the valuation date. The Account balance for the valuation calendar year includes any amounts rolled over or transferred to the Plan either in the valuation calendar year or in the distribution calendar year if distributed or transferred in the valuation calendar year.

8.3. ***Beneficiary Designation***.

(a) Each Participant may designate, on a form provided by the Administrator, one or more primary Beneficiaries or alternative Beneficiaries for all or a specified fractional part of his or her aggregate Accounts and may change or revoke any such designation from time to time. No such designation, change or revocation is effective unless executed by the Participant and received by the Administrator

during the Participant's lifetime. Subject to subsection (d), no such change or revocation requires the consent of any person.

(b) If a Participant

(i) fails to designate a Beneficiary, or

(ii) revokes a Beneficiary designation without naming another Beneficiary, or

(iii) designates one or more Beneficiaries none of whom survives the Participant,

for all or any portion of the Accounts, such Accounts or portion are payable to the first class of the following classes of automatic Beneficiaries that includes a member surviving the Participant:

Participant's spouse; and
Representative of Participant's estate.

(c) The automatic Beneficiaries specified above and, unless the designation otherwise specifies, the Beneficiaries designated by the Participant, become fixed as of the Participant's death so that, if a Beneficiary survives the Participant but dies before the receipt of all payments due such Beneficiary, any remaining payments are payable to the representative of such Beneficiary's estate. Any designation of a Beneficiary by name that is accompanied by a description of relationship or only by statement of relationship to the Participant is effective only to designate the person or persons standing in such relationship to the Participant at the Participant's death.

(d) Notwithstanding subsection (a), no designation of a Beneficiary other than the Participant's spouse is effective unless such spouse consents to the designation. Any such consent is effective only with respect to the Beneficiary or class of Beneficiaries so designated and only with respect to the spouse who so consented.

8.4. ***Assignment, Alienation of Benefits***.

(a) Except as required under a qualified domestic relations order or by the terms of any loan from the Trust or to comply with a federal tax levy pursuant to Code section 6331, and except as otherwise provided in Code section 401(a)(13)(C), (i) no benefit under the Plan may in any manner be anticipated, alienated, sold, transferred, assigned, pledged, encumbered or charged, and any attempt to do so is void and (ii) no benefit under the Plan is in any manner liable for or subject to the debts, contracts, liabilities, engagements or torts of the person entitled to such benefit.

(b) To the extent provided in a qualified domestic relations order, distribution of benefits assigned to an alternate payee by such order may be distributed to the alternate payee in the form of a lump sum payment prior to the Participant's

earliest retirement age. The terms "qualified domestic relations order," "alternate payee" and "earliest retirement age" have the meanings given in Code section 414(p).

8.5. ***Payment in Event of Incapacity***. If any person entitled to receive any payment under the Plan is physically, mentally or legally incapable of receiving or acknowledging receipt of the payment, and no legal representative has been appointed for such person, the Administrator in its discretion may (but is not required to) cause any sum otherwise payable to such person to be paid to any one or more of the following as may be chosen by the Administrator: the Beneficiaries, if any, designated by such person; the institution maintaining such person; a custodian for such person under the Uniform Transfers to Minors Act of any state; or such person's spouse, children, parents or other relatives by blood or marriage. Any such payment completely discharges all liability under the Plan to the person with respect to whom the payment is made to the extent of the payment.

8.6. ***Payment Satisfies Claims***. Any payment to or for the benefit of any Participant, or Beneficiary in accordance with the provisions of the Plan, to the extent of such payment, fully satisfies all claims against the Trustee, the Administrator and the Participating Employers, any of whom may require the payee to execute a receipted release as a condition precedent to such payment.

8.7. ***Disposition if Distributee Cannot be Located***. If the Administrator is unable to locate a Participant or Beneficiary to whom a distribution is due (or if a distribution check payable to a Participant or Beneficiary who does not have an Account balance is not cashed for six months), the amount that would otherwise be distributed to the Participant or Beneficiary will be forfeited, and the forfeited amount will be applied in accordance with Section 7.4. The forfeited amount will be restored to the Accounts from which the amount was forfeited, unadjusted for interest or any change in value occurring after the forfeiture, upon the Participant's or Beneficiary's claim for the benefit. The restoration will be made through funds available pursuant to Section 7.4(a). To the extent such funds are insufficient for such purpose, the Participating Employer with whom the Participant was last employed will contribute the amount required to restore the Accounts.

8.8. ***Direct Rollovers and Transfers***. To the extent a distribution is an Eligible Rollover Distribution, the Administrator will, if so instructed by the distributee in accordance with Plan Rules, direct the Trustee to make the distribution to an eligible retirement plan, within the meaning of Code section 402(c). The foregoing provision will not apply if the aggregate taxable distributions to be made to the distributee during the calendar year are less than $200 or, if the portion of the distribution to be distributed to the eligible retirement plan is less than $500 and is less than the entire taxable portion of the distribution.

ARTICLE 9.

CONTRIBUTION LIMITATIONS

9.1. ***401(k) Contribution Dollar Limitation***.

(a) The aggregate amount of 401(k) Contributions and other "elective deferrals" (within the meaning of Code section 402(g)(3)) under any other qualified plan maintained by an Affiliated Organization with respect to a Participant for any taxable year of the Participant may not exceed the limitation in effect for the taxable year under Code section 402(g). If the limitation is exceeded for any taxable year of the Participant, the portion of the excess specified by the Participating Employer, increased by Fund earnings or decreased by Fund losses attributable to the excess as determined by the Administrator in accordance with Treasury Regulations, will be distributed to the Participant.

(b) The amount distributed pursuant to this section to a Participant who has made elective deferrals for the taxable year other than pursuant to the Plan or another qualified plan maintained by an Affiliated Organization will, to the extent of such other elective deferrals, be determined in accordance with written allocation instructions received by the Administrator from the Participant not later than March 31 of the following the taxable year.

(c) A distribution pursuant to this section may be made at any time after the excess contributions are received, but not later than April 15 of the taxable year following the taxable year to which the limitation relates.

9.2. ***Actual Deferral Percentage Limitations***.

(a) Each Plan Year, the Plan will satisfy the requirements of Code section 401(k)(3) by satisfying the actual deferral percentage ("ADP") test described in Treasury Regulation section 1.401(k)-2 using the current year testing method described in such section.

(b) To the extent deemed advisable by the Administrator to comply with Code section 401(k)(3), the Administrator may, in accordance with Plan Rules, prospectively decrease a Participant's 401(k) Contributions.

(c) If, for any Plan Year, the requirements of Subsection (a) are not satisfied, the Administrator will determine the amount by which 401(k) Contributions made by each Highly Compensated Employee for the Plan Year exceeds the permissible amount as determined under Subsection (a). The determination will be made in accordance with Treasury Regulation section 1.401(k)-2(b)(2).

(d) The amount of excess 401(k) Contributions determined in accordance with Subsection (c), increased by Fund earnings or decreased by Fund losses attributable to such excess as determined in accordance with Treasury Regulation section 1.401(k)-2(b)(2), will be distributed to affected Highly Compensated Employees, at such time as the Administrator specifies on or following the last

day of the Plan Year for which the determination is made, but in no case later than the last day of the following Plan Year. The amount to be distributed with respect to any Plan Year will be reduced by the portion of the amount, if any, distributed pursuant to Section 9.1 that is attributable to 401(k) Contributions that relate to such Plan Year, determined by assuming that 401(k) Contributions in excess of the limitation described in Section 9.1 for a given taxable year are the first contributions made for a Plan Year falling within such taxable year.

(e) To the extent required or permitted by Treasury Regulations, the Administrator will or may, as the case may be, apply the limitation described in this section separately to each group of eligible employees who are included in a unit of Employees covered by a collective bargaining agreement.

(f) If the Administrator elects to apply Code section 410(b)(4)(B) in determining whether the Plan satisfies the ADP test for a Plan Year, all eligible employees who have not met either the minimum age and/or minimum service requirements of Code section 410(a)(1)(A) will be considered separately in accordance with the ADP test.

9.3. ***Actual Contribution Percentage Limitations.***

(a) For each Plan Year, the Plan will satisfy the requirements of Code section 401(m)(2) by satisfying the actual contribution percentage ("ACP") test described in Treasury Regulation section 1.401(m)-2 using the current year testing method described in such section.

(b) If, for any Plan Year, the requirements of Subsection (a) are not satisfied, the Administrator will determine the amount by which Matching Contributions made on behalf of each Highly Compensated Employee for the Plan Year exceeds the permissible amount as determined under Subsection (a), such determination being made in accordance with in accordance with Treasury Regulation section 1.401(m)-2(b)(2).

(c) The amount of excess Matching Contributions determined in accordance with Subsection (b), increased by Fund earnings or decreased by Fund losses attributable to such excess as determined in accordance with Treasury Regulation section 1.401(m)-2(b)(2), will be distributed to affected Highly Compensated Employees at such time as the Administrator specifies on or following the last day of the Plan Year for which the determination is made, but in no case later than the last day of the following Plan Year; provided, however, that to the extent the excess Matching Contributions would not be fully vested if retained in the Plan, such excess will be forfeited rather than distributed, and any such forfeitures will be applied as provided in Section 3.3(d).

(d) To the extent provided in Treasury Regulations, the limitations described in this section do not apply to any group of eligible employees who are included in a unit of Employees covered by a collective bargaining agreement.

(e) If the Administrator elects to apply Code section 410(b)(4)(B) in determining whether the Plan satisfies the ACP test for any Plan Year, all eligible employees who have not met either the minimum age and/or minimum service requirements of Code section 410(a)(1)(A) will be considered separately in accordance with the ACP test.

9.4. ***Annual Additions Limitation.***

(a) Notwithstanding any contrary provisions of the Plan, there will not be allocated to any Participant's Accounts for a Plan Year any amount that would cause the aggregate annual additions with respect to the Participant for the Plan Year to exceed the limitations of Code section 415(c) for the calendar year during which the Plan Year in question begins.

(b) The limitation of Subsection (a) will be applied as follows:

(i) To the extent deemed advisable by the Administrator, the Administrator may, in accordance with Plan Rules, prospectively decrease a Participant's 401(k) Contributions.

(ii) If a further reduction of contributions is required, the amount of the Profit Sharing Contribution that would otherwise be allocated to the Participant's Profit Sharing Account will be reduced and the aggregate amount of the Profit Sharing Contribution for the Plan Year will be reduced by the same amount and then Matching Contribution that would otherwise be allocated to the Participant's Account will be reduced and the aggregate amount of the Matching Contribution for the Plan Year will be reduced by the same amount.

(iii) If, in spite of such reduction and as a result of the allocation of forfeitures or a reasonable error in estimating the amount of the Participant's Eligible Earnings, Section 415 Wages, 401(k) Contributions or other elective deferrals within the meaning of Code section 402(g)(3) for the Plan Year, the limitation would otherwise be exceeded, then, to the extent required to prevent such excess:

(1) the amount of 401(k) Contributions made for the Participant, together with earnings on such contributions, will be distributed to the Participant and any Matching Contributions attributable to the amount so distributed, together with earnings on such contributions, will be forfeited and applied as provided in Section 3.3(e); then

(2) if a further excess would otherwise exist, the amount of such excess will be held unallocated in a suspense account and will be allocated to all other eligible Participants for the Plan Year and, to the extent necessary, subsequent Plan Years, before Matching and Profit Sharing Contributions are made for such Plan Year or Years,

and will be applied toward the amount of such contributions for such Plan Year or Years.

(iv) Any distribution or forfeiture under this section will be adjusted to reflect investment earnings or losses in the manner determined by the Administrator in accordance with Treasury Regulations.

9.5. ***Administrator's Discretion***. Notwithstanding the foregoing provisions of this article, the Administrator may apply the provisions of Sections 9.1 through 9.4 in any manner permitted by Treasury Regulations that will cause the Plan to satisfy the limitations of the Code incorporated in such sections, and the Administrator's good faith application of Treasury Regulations is binding on all Participants and Beneficiaries.

ARTICLE 10.

SERVICE RULES

10.1. ***Vesting Service***. The term "Vesting Service" with respect to an Employee means, except as provided in Section 10.5, the aggregate number of Plan Years during each of which the Employee completes at least 1000 Hours of Service.

10.2. ***One-Year Break in Service***. An Employee will incur a "One-Year Break in Service" if the Employee fails to complete at least 501 Hours of Service during a Plan Year; provided, that, for purposes only of determining whether an Employee has incurred such a One-Year Break in Service, in addition to Hours of Service credited under Section 10.5, there will be taken into account the number of Hours of Service that otherwise would have been credited to the Employee, or, if the number of such hours of service cannot be determined, eight hours of service for each day on which the Employee would have otherwise performed services for an Affiliated Organization, during an authorized leave of absence, while still employed with the Affiliated Organization, pursuant to any established, nondiscriminatory leave policy of an Affiliated Organization or due to:

(a) the Employee's pregnancy;

(b) the birth of the Employee's child;

(c) the placement of a child with the Employee in connection with the adoption of such child by the Employee; or

(d) the Employee's caring for such child for a period beginning immediately following such birth or placement;

provided, first, that the total number of such additional Hours of Service taken in to account by reason of any such absence will not exceed 501; second, that, if the Employee would be prevented from incurring a One-Year Break in Service for the Plan Year in which such absence commenced solely because the additional Hours of Service are so credited, such Hours of Service will be credited only to such Plan Year or, if a One-Year Break in Service for such Plan Year would not be so prevented, such additional Hours of Service will be credited to the Plan Year following the Plan Year during which such absence commenced; and third, that, notwithstanding the foregoing, no such additional Hours of Service will be credited in connection with an absence for one of the reasons set forth at items (a) through (d) unless the Employee furnishes to the Administrator, on a timely basis, such information as the Administrator reasonably requires in order to establish the number of days during which the Employee was absent for that reason. In addition, an Employee will be credited with Hours of Service for the purpose of determining whether he or she has incurred a One-Year Break in Service to the extent required by the Family and Medical Leave Act of 1993.

10.3. ***Loss of Service***. If an Employee terminates employment and experiences at least five consecutive One-Year Breaks in Service, then:

(a) if the Employee had a vested interest in his or her Account prior to the Breaks in Service,

(i) his or her Vesting Service completed prior to such Breaks in Service will be taken into account in determining his or her vested interest in his or her Accounts attributable to contributions made for periods after the Breaks in Service but only if the Employee completes one year of Vesting Service following such Breaks in Service and

(ii) the extent of the Employee's vested interest in his or her Accounts as determined under Section 7.1 prior to the Breaks in Service will not be increased by Vesting Service completed following the Breaks in Service; or

(b) if the Employee had no vested interest in his or her Account prior to the Breaks in Service, the Employee's service completed prior to the Breaks in Service will not be taken into account for any purpose under the Plan.

10.4. ***Pre-Acquisition Service***. Service with an entity (all or any portion of which is acquired by, merges with or becomes an Affiliated Organization) for any period prior to the date of the acquisition, merger or affiliation will be taken into account under this Plan only if, to the extent and for the purposes, specified on an exhibit to the Plan, as provided for in Section 14.1(f).

10.5. ***Hour of Service***.

(a) Subject to the remaining subsections of this section, the term "Hour of Service," with respect to an Employee, includes and is limited to:

(i) each hour for which the Employee is paid, or entitled to payment, for the performance of duties for an Affiliated Organization;

(ii) each hour:

(1) for which the Employee is paid, or entitled to payment, by an Affiliated Organization on account of a period of time during which no duties are performed (irrespective of whether the employment relationship has terminated) due to vacation, holiday, illness (including disability), layoff, jury duty, military duty or leave of absence;

(2) for which the Employee is not paid or entitled to payment but which is required by federal law to be credited to the Employee on account of his or her military service or similar duties; and

(3) for which back pay, irrespective of mitigation of damages, is either awarded or agreed to by an Affiliated Organization; provided, first, that Hours of Service taken into account under clause (i), (ii)(1) or (ii)(2) will not also be taken into account under this clause (3); and second, that Hours of Service taken into account under this clause (3) that relate to periods specified in clause (ii)(1) will be subject to the rules under subsection (b).

(b) The following rules will apply for purposes of determining the Hours of Service completed by an Employee under subsection (a)(ii)(1):

(i) No more than 501 hours will be credited to the Employee on account of any single continuous period during which the Employee performs no duties (whether or not such period occurs in a single Plan Year);

(ii) No more than the number of hours regularly scheduled for the performance of duties for the period during which no duties are performed will be credited to the Employee for such period;

(iii) The Employee will not be credited with hours for which payments are made or due under a plan maintained solely for the purpose of complying with workers compensation, unemployment compensation or disability insurance laws, or for which payments are made solely to reimburse the Employee for medical or medically related expenses;

(iv) A payment will be deemed to be made by or due from an Affiliated Organization, regardless of whether such payment is made by or due from the Affiliated Organization directly or indirectly through a trust fund or insurer to which the Affiliated Organization contributes or pays premiums;

(v) If the payment made or due is calculated on the basis of units of time, the number of Hours of Service to be credited will be the number of regularly scheduled working hours included in the units of time on the basis of which the payment is calculated; provided, that, if such a payment is made to an Employee described in subsection (d)(i), the number of Hours of Service to be credited will be the number of equivalent hours determined under subsection (d)(i) that are included in the units of time on the basis of which the payment is calculated;

(vi) If the payment made or due is not calculated on the basis of units of time, the number of Hours of Service to be credited will be equal to the amount of the payment, divided by the Employee's most recent hourly rate of compensation before the period during which no duties are performed; and

(vii) Hours will be determined in accordance with Section 2530.200(b)-2(b) of the Department of Labor Regulations which is incorporated herein by reference.

(c) Hours of Service will be credited:

(i) in the case of Hours of Service described in subsection (a)(i), to the Plan Year in which the duties are performed;

(ii) in the case of Hours of Service described in subsection (a)(ii)(1), to the Plan Year or Plan Years in which the period during which no duties are performed occurs; provided, that, if the payment is not calculated on the basis of units of time, the Hours of Service will not be allocated between more than the first two Plan Years of such period;

(iii) in the case of Hours of Service described in subsection (a)(ii)(2), to the Plan Year or Plan Years determined by the Administrator in accordance with the applicable federal law;

(iv) in the case of Hours of Service described in subsection (a)(ii)(3), to the Plan Year or Plan Years to which the award or agreement for back pay pertains; and

(v) as otherwise provided in Section 2530.200(b)-2(c) of the Department of Labor Regulations which is incorporated herein by reference.

(d) For purposes of determining the number of Hours of Service completed by an Employee during a particular period of time:

(i) an Employee who is not subject to the overtime provisions of the Fair Labor Standards Act of 1938, as from time to time amended, will be credited with 45 Hours of Service for each week during which he or she completes at least one Hour of Service; and

(ii) each other Employee will be credited with the number of Hours of Service that he or she completes during such period.

(e) Notwithstanding the foregoing provisions of this section, an individual will be credited with the number of Hours of Service he or she completes, determined in the manner specified in subsections (a) through (d):

(i) while a Leased Employee; and

(ii) with any other organization to the extent such Hours of Service are required to be taken into account pursuant to Treasury Regulations under Code sections 414(n) and 414(o).

ARTICLE 11.

ADOPTION, AMENDMENT AND TERMINATION

11.1. ***Adoption by Affiliated Organizations***. With the prior approval of the Administrator, an Affiliated Organization may adopt this Plan and become a Participating Employer. Any special provisions applicable to a Participating Employer's Employees will be set forth on an exhibit to the Plan.

11.2. ***Authority to Amend and Procedure***.

(a) The Company reserves the right to amend the Plan at any time, to any extent. Each amendment must be stated in a written instrument signed by an officer of the Company. On and after the effective date of the amendment, all interested persons will be bound by the amendment; provided, that no amendment will have any retroactive effect so as to deprive any Participant, or any Beneficiary of a deceased Participant, of any benefit already accrued or vested or of any option with respect to the form of such benefit that is protected under Code section 411(d)(6), except that an amendment required to qualify the Trust for income tax exemption may be retroactive to the Effective Date of the Plan or to any later date.

(b) If the provisions for determining the extent to which benefits under the Plan are vested are changed, whether by amendment or because of the Plan's becoming or ceasing to be a top-heavy plan, each Participant who has completed at least three years of Vesting Service may elect to have his or her vested benefits determined without regard to such change by giving written notice of such election to the Administrator within the period beginning on the date such change was adopted (or the Plan's top heavy status changed) and ending 60 days after the latest of: (i) the date such change is adopted; (ii) the date such change becomes effective; and (iii) the date the Administrator issues notice of such change to the Participant.

(c) The provisions of the Plan in effect at the termination of a Participant's employment will, except as specifically provided in any subsequent amendment, continue to apply to such Participant.

11.3. ***Authority to Terminate and Procedure***. The Company expects to continue the Plan indefinitely but reserves the right to terminate the Plan in its entirety at any time by a written instrument of termination signed by an officer of the Company. Each Participating Employer expects to continue its participation in the Plan indefinitely but reserves the right to cease its participation in the Plan at any time by a written instrument delivered to the Administrator.

11.4. ***Procedures.*** Any instrument under this article must be executed by an authorized officer of the acting entity.

11.5. ***Vesting Upon Termination, Partial Termination or Discontinuance of Contributions***. Upon the termination of the Plan or upon the complete discontinuance of contributions, the Accounts of each "affected employee" will vest in full. For purposes of this section, "affected employee" means:

(a) a Participant who is actively employed with an Affiliated Organization on the effective date of the termination or complete discontinuance of contributions;

(b) a Participant who has a Severance from Employment and has neither received a complete distribution of his or her Account nor experienced at least five consecutive One-Year Breaks in Service;

(c) a former Participant who had a Severance from Employment during the Plan Year that includes the effective date of the termination or complete discontinuance of contributions.

Upon a partial termination of the Plan, the Accounts of each Participant as to whom the Plan has been partially terminated will vest in full.

11.6. ***Distribution Following Termination, Partial Termination or Discontinuance of Contributions***. After termination or partial termination of the Plan or the complete discontinuance of contributions under the Plan, the Trustee will continue to hold and distribute the Fund as if such event had not occurred, but if the Administrator so directs in accordance with Treasury Regulations, the Trustee will distribute to each Participant the entire balance of his or her Accounts.

ARTICLE 12.
PLAN ADMINISTRATION

12.1. ***Administrator, Named Fiduciary***. The general administration of the Plan and the duty to carry out its provisions is vested in the Administrator, who is the sole "named fiduciary" of the Plan for such purposes under ERISA; the Administrator is also the sole "named fiduciary" of the Plan with respect to the appointment and removal of members of the Investment Committee and monitoring the Company Stock Fund in accordance with Section 5.5. The Investment Committee is the sole "named fiduciary" of the Plan with respect to selecting and monitoring the Plan's investment funds (other than the Company Stock Fund) and selecting, monitoring and removing the Trustee.

12.2. ***Duties of Administrator***. The Administrator has the discretionary power and authority, and the responsibility, to:

(a) adopt rules, regulations and procedures not inconsistent with the provisions of the Plan and uniform and equitable with respect to individuals determined by the Administrator to be similarly situated at the time in question, and to revoke or modify such rules and regulations at any time;

(b) interpret, construe, apply and enforce the provisions of the Plan and any Plan Rules, including the discretionary and final power and authority to interpret, construe, apply and enforce uncertain provisions of the Plan or Plan Rules, and remedy possible ambiguities, inconsistencies, omissions and errors, and any such action taken by the Administrator in good faith is binding upon all Participants, Beneficiaries, alternate payees and other interested persons;

(c) determine from time to time the status of all Employees, Qualified Employees, Participants, Beneficiaries, alternate payees and other interested persons for purposes of the Plan;

(d) determine the rights of Employees, Qualified Employees, Participants, Beneficiaries, alternate payees and other interested persons to benefits under the Plan, the amount and the method and time or times of payment of the benefit;

(e) appoint, monitor and remove the members of the Investment Committee;

(f) monitor the Company Stock Fund; and

(g) take any other actions required by the Plan or determined by the Administrator to be necessary or advisable to in connection with the administration of the Plan.

12.3. ***Delegation***. Except as otherwise provided in ERISA, the Administrator may delegate specific Plan administration duties, including fiduciary duties and responsibilities. Such delegations may be to Employees or to other individuals, committees or entities. Any delegation may, if specifically stated, allow further delegations by the individual, committee or entity to whom or which the delegation has been made subject to and in accordance with any limitations, restrictions or conditions specified in the delegation or

in any other written instrument provided by the Administrator to the individual, committee or entity to whom or which the delegation has been made. Any delegation may be rescinded by the Administrator at any time. Each individual, committee or entity to whom or which a fiduciary duty or responsibility has been delegated is responsible for the exercise of such duties or responsibilities and is not responsible for the acts or failure to act of any other fiduciary. Any delegation by the Administrator of a fiduciary duty or responsibility relating to Plan Administration, other than to a person for whose conduct the Administrator remains responsible, must be in writing, and the individual, committee or entity to whom or which the delegation is made must submit a written acceptance of the delegation to the Administrator. Any delegate's duty will terminate upon withdrawal of such authority by the Administrator or upon withdrawal of the delegate's acceptance. Any delegation to an Employee will automatically terminate when he or she ceases to be an Employee. The Administrator retains the sole responsibility for – and fiduciary duties and responsibilities with respect to – monitoring the Company Stock Fund and appointing (or removing) the members of the Investment Committee and the Administrator may not delegate any such duties or responsibilities to any individual, committee or entity.

12.4. ***Reports and Records***. The Administrator and those individuals, committees or entities to whom or which the Administrator has delegated fiduciary duties will keep records of all their proceedings and actions, and will maintain all such books of account, records and other data as necessary for the proper administration of the Plan and to comply with applicable law.

12.5. ***Compensation***. No employee of an Affiliated Organization acting in a fiduciary capacity will be entitled to receive compensation from the Trust for such services, but each will be entitled to reimbursement from the Trust for all sums reasonably and necessarily expended in the performance of such duties.

12.6. ***Professional Assistance***. The Administrator may retain such accounting, recordkeeping, legal, clerical and other services as may reasonably be required in the administration of the Plan, and may pay reasonable compensation for such services. The Administrator is entitled to rely conclusively on all tables, valuations, certificates, opinions and reports furnished to the Administrator by such persons and on all information, elections and designations furnished to the Administrator by Participants, Beneficiaries, alternate payees and Participating Employers.

12.7. ***Payment of Administrative Costs***. All costs of administering the Plan, including services referenced in Section 12.6, may be paid by the Trustee from the Trust, but if not so paid, will be paid by the Participating Employers.

12.8. ***Indemnification***.

(a) To the extent permitted by law, the Participating Employers jointly and severally agree to indemnify and hold harmless the Administrator, the members of the Investment Committee or any other committee and other employees, officers or directors of an Affiliated Organization to whom fiduciary duties are delegated against any and all claims, losses, damages, expenses and liabilities arising from their responsibilities in connection with the Plan which are not otherwise paid or reimbursed, unless they are determined to be due to gross negligence or intentional misconduct. The Company has the right, but not the obligation, to select counsel and control the defense and settlement of any action for which an individual may be entitled to indemnification pursuant to this section.

(b) An individual's right to indemnification pursuant to this section is in addition to, and independent of, the individual's right, if any, to indemnification pursuant to a Participating Employer's articles of incorporation or bylaws (or comparable governing instruments), applicable law or otherwise, but an individual is not entitled to indemnification from all sources in an amount that exceeds his or her claims, losses, damages, expenses and liabilities.

12.9. ***Claims Procedure***.

(a) The Administrator will notify a Participant in writing, within 90 days of the Participant's written application for benefits, of the Participant's eligibility or non-eligibility for benefits under the Plan. If the Administrator determines that a Participant is not eligible for benefits or full benefits, the notice will:

(i) state the specific reasons for the denial of any benefits;

(ii) provide a specific reference to the provision of the Plan on which the denial is based;

(iii) provide a description of any additional information or material necessary for the claimant to perfect the claim, and a description of why it is needed;

(iv) state that the claimant will be provided, on request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claim;

(v) state the claimant's right to bring a civil action under ERISA Section 502(a) following a continued denial of a claim after appeal review; and

(vi) provide an explanation of the Plan's claims review procedure and other appropriate information as to the steps to be taken if the Participant wishes to have the claim reviewed.

If the Administrator determines that there are special circumstances requiring additional time to make a decision, the Administrator will notify the Participant of

the special circumstances and the date by which a decision is expected to be made, and may extend the time for up to an additional 90-day period.

(b) If a Participant is determined by the Administrator not to be eligible for benefits or if the Participant believes that he or she or she is entitled to greater or different benefits, the Participant will be provided the opportunity to have his or her claim reviewed by the Administrator by filing a petition for review with the Administrator within 60 days after the Participant receives the notice issued by the Administrator. The petition must state the specific reasons the Participant believes he or she or she is entitled to benefits or greater or different benefits. Within 60 days after the Administrator receives the petition, the Administrator will give the Participant (and his or her counsel, if any) an opportunity to present his or her position to the Administrator in writing, and the Participant (or his or her counsel) may review the pertinent documents, and the Administrator will notify the Participant of its decision in writing within such 60-day period, stating specifically the basis of the decision written in a manner calculated to be understood by the Participant and the specific provisions of the Plan on which the decision is based. If because of special circumstances requiring additional time to make a decision, the 60-day period is not sufficient, the decision may be deferred for up to another 60-day period at the election of the Administrator, but notice of this deferral must be given to the Participant.

(c) In the event of the death of a Participant, the same procedure applies to the Beneficiary of the Participant.

(d) A claimant must exhaust the procedure described in this section before pursuing the claim in any other proceeding.

12.10. ***Disputes***.

(a) A Participant, Beneficiary or alternate payee may not commence a civil action pursuant to ERISA section 502(a)(1), with respect to a benefit under the Plan after the earlier of:

(i) three years after the occurrence of the facts or circumstances that give rise to or form the basis for such action; and

(ii) one year from the date the Participant, Beneficiary or alternate payee had actual knowledge of the facts or circumstances that give rise to or form the basis for such action.

(b) In the case of a dispute between a Participant, Beneficiary, alternate payee or other person claiming a right or entitlement pursuant to the Plan and a Participating Employer, the Administrator, the Investment Committee or other person relating to or arising from the Plan, the United States District Court for the District of Minnesota is a proper venue. Regardless of where an action relating to or arising from the Plan is pending, the law as stated and applied by the United States Court of Appeals for the Eighth Circuit or the United States District Court

for the District of Minnesota will apply to and control all actions relating to the Plan brought against the Plan, a Participating Employer, the Administrator, the Investment Committee or any other person or against any Participant, Beneficiary, alternate payee or other person claiming a right or entitlement pursuant to the Plan.

12.11. ***Correction of Errors***. If the Administrator determines that, by reason of administrative error or other cause attributable to a Participating Employer, the Account of any Participant has incurred a loss, the Administrator may enter into an agreement with the Participating Employer under which the Account is fully restored and may, upon such restoration, release the Participating Employer from further responsibility.

12.12. ***Standards for Elections, Directions and Similar Actions***. Any election, direction, application, designation or similar action required of a Participant, Beneficiary or alternate payee (or any person claiming by, through or on behalf of a Participant, Beneficiary or alternate payee) pursuant to the Plan must be made in accordance with and is subject to the terms of the Plan and Plan Rules.

ARTICLE 13.
MISCELLANEOUS

13.1. ***Merger, Consolidation, Transfer of Assets***. If this Plan is merged or consolidated with, or his or her assets or liabilities are transferred to, any other plan, each Participant will be entitled to receive a benefit immediately after such merger, consolidation or transfer (if such other plan were then terminated) that is equal to or greater than the benefit he or she would have been entitled to receive immediately before such merger, consolidation or transfer (if this Plan had then terminated but without regard to Section 11.5). No such transfer will be made unless the Administrator has determined that the other plan will apply the Code section 401(k) distribution restrictions to the transferred 401(k) accounts.

13.2. ***Limited Reversion of Fund***.

(a) Except as provided in subsection (b), no corpus or income of the Trust will at any time revert to any Affiliated Organization or be used other than for the exclusive benefit of Participants and their Beneficiaries by paying benefits and administrative expenses of the Plan.

(b) Notwithstanding any contrary provision in the Plan, to the extent a contribution is made by a Participating Employer by a mistake of fact or a deduction is disallowed a Participating Employer under Code section 404, the Trustee will repay the contribution to the Participating Employer upon the Participating Employer's written request; provided, that such repayment must be made within one year after the mistaken payment is made or the deduction is disallowed, as the case may be. Each contribution to the Plan by a Participating Employer is expressly conditioned on such contribution's being fully deductible by the Participating Employer under Code section 404.

13.3. ***Top-Heavy Provisions***.

(a) If the Plan becomes a "top-heavy plan," the following provisions will apply to, and control the operation and administration of, the Plan for those Plan Years during which the Plan is a top-heavy plan; provided, however, that the top-heavy requirements of this section will not apply in any year in which the Plan consists solely of a cash or deferred arrangement that meets the requirements of Code section 401(k)(12) and matching contributions with respect to which the requirements of Code section 401(m)(11) are met.

(i) Notwithstanding the provisions of Article 3, the amount of contributions (excluding 401(k) Contributions) made and allocated for such Plan Year on behalf of each Active Participant who is not a key employee and who is employed with a Participating Employer or another Affiliated Organization on the last day of the Plan Year (whether or not such Participant completed at least 1000 Hours of Service during the Plan Year), expressed as a percentage of the Participant's Testing Wages for the Plan Year, will be at least equal to the lesser of:

(1) three percent; or

(2) the largest percentage of such Testing Wages at which contributions (including 401(k) Contributions) are made and allocated on behalf of any key employee for such Plan Year.

(ii) If, in addition to this Plan, the Participating Employer or another Affiliated Organization maintains another qualified defined contribution plan or one or more qualified defined benefit pension plans during a Plan Year, the provisions of clause (1) will be applied for such Plan Year -

(1) by taking into account the Participating Employer contributions (other than elective contributions for a non-key employee) on behalf of the Participant under all such defined contribution plans;

(2) without regard to any Participant who is not a key employee and whose accrued benefit, expressed as a single life annuity, under a defined benefit pension plan maintained by the Participating Employer or another Affiliated Organization for such Plan Year is not less than the product of -

(A) the Participant's average Testing Wages for the period of consecutive years not exceeding the period of consecutive years (not exceeding five) when the Participant had the highest aggregate Testing Wages, disregarding years in which the Participant completed less than 1,000 Hours of Service, multiplied by

(B) the lesser of (A) two percent per year of service, disregarding years of service beginning after the close of the last Plan Year in which such defined benefit plan was a top heavy plan, or (B) 20 percent.

(iii) Each Participant's vested interest in the Matching Contribution Account will be the vested interest determined under the preceding provisions of the Plan or determined in accordance with the following schedule, whichever provides the greater vested interest for the Participant:

Years of Vesting Service	Extent of Vested Interest
Less than Two Years	0%
Two Years	20%
Three Years	40%
Four Years	60%
Five Years	80%
Six or more Years	100%

If the Plan ceases to be a top-heavy plan, the portion of a Participant's Matching Contribution Account that has vested pursuant to the foregoing schedule will remain nonforfeitable.

(b) For purposes of subsection (a),

(i) The Plan will be a "top-heavy plan" for a particular Plan Year if, as of the last day of the initial Plan Year or, with respect to any other Plan Year, as of the last day of the preceding Plan Year, the aggregate of the Account balances of key employees is greater than 60% of the aggregate of the Account balances of all Participants. The following rules will apply for purposes of calculating the aggregate Account balances for both key employees and employees who are not key employees.

(1) The present values of accrued benefits and the amounts of account balances of an employee as of the determination date shall be increased by the distributions made with respect to the employee under the Plan and any plan aggregated with the Plan under Code section 416(g)(2) during the 1-year period ending on the determination date. The preceding sentence shall also apply to distributions under a terminated plan which, had it not been terminated, would have been aggregated with the Plan under Code section 416(g)(2)(A)(i). If a distribution is made for a reason other than severance from employment, death or disability this provision shall be applied by substituting "5-year period" for "1-year period."

(2) Amounts transferred or rolled over from a plan not maintained by a Participating Employer or another Affiliated Organization at the initiation of the Participant will be excluded.

(3) The accrued benefits and accounts of any individual who has not performed services for the employer during the 1-year period ending on the determination date shall not be taken into account.

(4) The terms "key employee" and "employee" will include the Beneficiaries of such persons who have died.

(ii) Notwithstanding the provisions of clause (1), this Plan will not be a top-heavy plan if it is part of either a "required aggregation group" or a "permissive aggregation group" and such aggregation group is not top-heavy. An aggregation group will be top-heavy if the sum of the present value of accrued benefits and account balances of key employees is more than 60% of the sum of the present value of accrued benefits and account balances for all Participants, such accrued benefits and account balances being calculated in each case in the same manner as set forth in clause (1). Each plan in a required aggregation group will be top-heavy if the group is

top-heavy. No plan in a required aggregation group will be top-heavy if the group is not top-heavy. If a permissive aggregation group is top-heavy, only those plans that are part of an underlying top-heavy, required aggregation group will be top-heavy. No plan in a permissive aggregation group will be top-heavy if the group is not top-heavy.

(iii) The "required aggregation group" consists of (i) each plan of an Affiliated Organization in which a key employee participates, and (ii) each other plan of an Affiliated Organization that enables a plan in which a key employee participates to meet the nondiscrimination requirements of Code sections 401(a)(4) and 410.

(iv) A "permissive aggregation group" consists of those plans that are required to be aggregated and one or more plans (providing comparable benefits or contributions) that are not required to be aggregated, which, when taken together, satisfy the requirements of Code sections 401(a)(4) and 410.

(v) For purposes of applying clauses (ii), (iii) and (iv) of this subsection, any qualified defined contribution plan maintained by a Participating Employer or another Affiliated Organization at any time within the five-year period preceding the Plan Year for which the determination being made which, as of the date of such determination, has been formally terminated, has ceased crediting service for benefit accruals and vesting and has been or is distributing all plan assets to participants or their beneficiaries, will be taken into account to the extent required or permitted under such clauses and under Code section 416.

(c) The term "key employee" means any employee or former employee (including any deceased employee) who, at any time during the Plan Year that includes the determination date, was an officer of the employer having annual compensation greater than $130,000 (as adjusted under Code section 416(i)(1)), a five-percent owner of the employer, or a one-percent owner of the employer having annual compensation of more than $150,000. For this purpose, annual compensation means compensation within the meaning of Code section 415(c)(3). The determination of key employees will be made in accordance with Code section 416(i)(1) of the Code and Treasury Regulations.

(d) Matching Contributions will be taken into account for purposes of satisfying the minimum contribution requirements of Code section 416(c)(2) and the Plan. The preceding sentence shall apply with respect to Matching Contributions under the Plan or, if the Plan provides that the minimum contribution requirement shall be met in another plan, such other plan. Matching Contributions that are used to satisfy the minimum contribution requirements shall be treated as matching contributions for purposes of the actual contribution percentage test and other requirements of Code section 401(m).

13.4. ***Qualified Military Service*.**

(a) The provisions of this section apply only to an Employee who is reemployed by a Participating Employer and whose reemployment rights are protected under the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA") and are intended to comply with the requirements of Code section 414(u).

(b) Notwithstanding any other provisions of the Plan to the contrary, a Qualified Employee who leaves the employ of a Participating Employer for qualified military service and returns to employment with a Participating Employer will be entitled to the restoration of benefits under the Plan which would have accrued but for the Qualified Employee's absence due to qualified military service.

(c) A Qualified Employee may make 401(k) Contributions (including Catch-Up Contributions) for the Plan Years during which he or she would have been an Active Participant but for his or her qualified military service in accordance with Section 3.1 and Section 3.2 and the following additional rules:

(i) the Qualified Employee may elect to make 401(k) Contributions (including Catch-Up Contributions) subject to the maximums in effect pursuant to Sections 3.1 and 3.2 during the period of qualified military service;

(ii) the Qualified Employee may make the election described in clause (i) at any time during the period that begins on his or her date of reemployment and has the same length as the lesser of five years or the period of the Qualified Employee's qualified military service multiplied by three;

(iii) the 401(k) Contributions (including Catch-Up Contributions) under this subsection are not subject to the limitations described in Section 9.2 or Section 9.3.

(d) A Qualified Employee's Participating Employer will make Matching Contributions with respect to the Qualified Employee's 401(k) Contributions pursuant to subsection (c) in the same amount as if such 401(k) Contributions had actually been made during the Participant's period of qualified military service. The Matching Contributions made pursuant to this subsection are not subject to the limitations described in Section 9.3.

(e) The following additional rules and conditions apply with respect to qualified military service notwithstanding any contrary provision of the Plan:

(i) an Employee will not be treated as having incurred a break in service by reason of his or her qualified military service;

(ii) any period of qualifying military service will be counted as Vesting Service;

(iii) for purposes of determining the Qualified Employee's Eligible Earnings and Section 415 Wages, the Qualified Employee will be treated as receiving compensation from the Participating Employer with whom he or she was employed immediately before the period of qualified military service during the period of qualified military service in an amount equal to the compensation he or she would have received during such period if he or she were not in qualified military service determined based on the rate of pay the Qualified Employee would have received from the Participating Employer but for the absence due to qualified military service; provided, however, if the compensation the Qualified Employee would have received from the Participating Employer is not reasonably certain, then the Qualified Employee's rate of compensation will be equal to his or her average compensation for the 12-month period preceding the qualified military service (or, if shorter, the period of employment immediately preceding the qualified military service);

(iv) contributions on behalf or by the Qualified Employee will be subject to the limitations in Sections 9.1 and 9.4 with respect to the Plan Years to which such contributions relate in accordance with Treasury Regulations;

(v) the Qualified Employee will not be entitled to any crediting of earnings on contributions for any period prior to actual payment to the Trust; and

(vi) the Qualified Employee will not be entitled to restoration of any forfeitures which were not allocated to his or her Account as a result of his or her qualified military service.

(f) For purposes of this section, "qualified military service" means any service in the uniformed services as defined in USERRA by a Qualified Employee who is entitled to reemployment rights with a Participating Employer under USERRA.

13.5. ***Short Plan Years***. To the extent required by and in accordance with Treasury Regulations, for any Plan Year that is less than 12 months long, the dollar limitations in effect for purposes of Code sections 401(a)(17), 414(q), 415 and 416 will be adjusted to reflect the short Plan Year.

ARTICLE 14.
CONSTRUCTION, INTERPRETATIONS AND DEFINITIONS

14.1. ***Construction and Interpretations***. The rules of construction and interpretations set forth in this section apply in construing this instrument unless the context otherwise indicates.

(a) ***Consent of Spouse***. Whenever the consent of a Participant's spouse is required with respect to any act of the Participant, such consent will be deemed to have been obtained only if:

(i) the Participant's spouse executes a written consent to such act, which consent acknowledges the effect of such act and is witnessed by a Plan representative or a notary public; or

(ii) the Administrator determines that no such consent can be obtained because the Participant has no spouse, because the Participant's spouse cannot be located, or because of such other circumstances as may, under Treasury Regulations, justify the lack of such consent.

Any such consent by the Participant's spouse or such determination by the Administrator that such spouse's consent is not required is effective only with respect to the particular spouse of the Participant who so consented or with respect to whom such determination was made. Any such consent by the Participant's spouse to an act of the Participant under the Plan is irrevocable with respect to that act.

(b) ***Governing Law***. To the extent that state law is not preempted by provisions of ERISA or any other laws of the United States, this Plan will be administered, construed, and enforced according to the internal, substantive laws of the State of Minnesota, without regard to its conflict of laws rules.

(c) ***Headings***. The headings of articles and sections are included solely for convenience. In the case of a conflict between a heading and the text of the Plan, the text controls.

(d) ***No Employment Rights Created***. The establishment and maintenance of the Plan neither gives any Employee a right to continuing employment nor limits the right of an Affiliated Organization to discharge or otherwise deal with the Employee without regard to the effect such action might have on his or her initial or continued participation in the Plan.

(e) ***Number and Gender***. Wherever appropriate, the singular number may be read as the plural, the plural may be read as the singular, and the masculine gender may be read as the feminine gender.

(f) ***Special Provisions***. Special provisions of the Plan applicable only to certain Participants will be set forth on an exhibit to the Plan. In the event of a conflict between the terms of the exhibit and the terms of the Plan, the exhibit controls.

14.2. ***Definitions***. The definitions set forth in this section apply in construing this instrument unless the context otherwise indicates.

Account. An "Account" with respect to a Participant is any or all of the accounts maintained on his or her behalf pursuant to Section 4.1, as the context requires.

Active Participant. An "Active Participant" is a Participant who is a Qualified Employee.

Administrator. The "Administrator" of the Plan is the individual holding the title of "Vice President of Compensation & Benefits of Select Comfort Corporation."

Affiliated Organization. An "Affiliated Organization" is the Company and any other corporation that is a member of a controlled group of corporations (within the meaning of Code section 1563(a) without regard to Code sections 1563(a)(4) and 1563(e)(3)(C)) that includes the Company, any trade or business (whether or not incorporated) that together with the Company is under common control (within the meaning of Code section 414(c)), any member of an "affiliated service group" (within the meaning of Code section 414(m)) of which the Company is a member or any other organization that, together with the Company, is treated as a single employer pursuant to Code section 414(o) and Treasury Regulations thereunder; provided, that, for purposes of applying the limitations set forth at Section 9.4, such determination under Code section 1563(a) will be made by substituting the phrase "more than 50 percent" for the phrase "at least 80 percent" wherever it appears in such Code section.

Beneficiary. A "Beneficiary" is a person designated or otherwise determined under the provisions of Section 8.3 as the distributee of benefits payable after the death of a Participant. A person designated as, or otherwise determined to be, a Beneficiary under the terms of the Plan has no interest in or rights under the Plan until the Participant in question has died. A Beneficiary will cease to be such on the day on which all benefits to which he, she or it is entitled under the Plan have been distributed.

Board. The "Board" is the board of directors or comparable governing body of the Affiliated Organization in question. When the Plan provides for an action to be taken by the Board, the action may be taken by any committee or individual authorized to take such action pursuant to a proper delegation by the board of directors or comparable governing body in question.

Catch-Up Contributions. "Catch-Up Contributions" are 401(k) Contributions made by Participants pursuant to Section 3.2.

Code. The "Code" is the Internal Revenue Code of 1986, as amended. Any reference to a specific provision of the Code includes a reference to such provision, any valid ruling, regulation or authoritative pronouncement promulgated thereunder and any provision of future law that amends, supplements or supersedes the provision.

Company. The "Company" is Select Comfort Corporation or any successor thereto.

Company Stock Fund. The "Company Stock Fund" is one of the Plan's investment funds and is invested exclusively in Company common stock except for cash held pending investment, transfer or distribution.

Disabled. A Participant will be considered to be "Disabled" only if:

(a) in the case of a Participant who is participating in the Participating Employer's long-term disability plan, he or she is receiving disability benefits under such plan, or

(b) in the case of any other Participant, he or she is certified as being disabled by the Social Security Administration and is receiving disability benefits under the disability provisions of the Social Security Act.

Effective Date. The Plan's original "Effective Date" was January 1, 1994. The effective date of this Restatement of the Plan is January 1, 2007.

Eligible Earnings. The "Eligible Earnings" of a Participant from a Participating Employer for any Plan Year means the wages, tips and other compensation reported in Box 1 on the Participant's Form W-2 from the Participating Employer for such Plan Year, adjusted as follows:

(a) Eligible Earnings excludes fringe benefits (such as automobile allowances, merchandise discounts and gift certificates), moving and relocation expenses, severance payments, salary continuation payments, sick payments paid by a third party payor, state disability payments, imputed income with respect to group term life insurance coverage and domestic partner benefits, amounts realized by the exercise of stock options, any amounts realized by vesting of restricted stock and performance stock, tuition reimbursements, executive financial planning reimbursements and payments received by the Participant pursuant to the Select Comfort Executive Investment Plan.

(b) Eligible Earnings for any period are increased by the sum of the Participant's 401(k) Contributions and Eligible Earnings reductions experienced by the Participant pursuant to any cafeteria plan maintained by the Participating Employer pursuant to Code section 125 or qualified transportation fringe benefit program maintained by the Participating Employer pursuant to Code section 132(f), to the extent such 401(k) Contributions or reductions are not otherwise included for such period.

(c) In no event will a Participant's Eligible Earnings for any Plan Year be taken into account to the extent it exceeds $200,000, as adjusted for cost-of-living increases in accordance with Code section 401(a)(17)(B). The cost-of-living adjustment in effect for a calendar year applies to Eligible Earnings for the Plan Year that begins with or within such calendar year.

Eligible Rollover Distribution.

(a) An "Eligible Rollover Distribution" means any distribution to a Participant, to a Participant's surviving spouse or to an Alternate Payee who is the Participant's spouse or former spouse; except that such term does not include—

(i) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made—

(1) for the life (or life expectancy) of the Participant or the joint lives (or joint life expectancies) of the Participant and a Beneficiary, or

(2) for a specified period of 10 years or more;

(ii) any distribution to the extent it is required by Code section 401(a)(9);

(iii) any elective distribution of Company stock dividends from the Participant's ESOP Account; and

(iv) any hardship distribution described in Code section 401(k)(2)(B)(i)(IV).

(b) A portion of a distribution shall not fail to be an Eligible Rollover Distribution merely because the portion consists of after-tax contributions that are not includible in gross income. Such after-tax portion may be transferred only to an individual retirement account or annuity described in section 408(a) or (b) of the Code, or to a qualified defined contribution plan described in section 401(a) or 403(a) of the Code that agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution that is includible in gross income and the portion of such distribution that is not so includible.

Employee. An "Employee" is any individual who performs services for an Affiliated Organization as a common-law employee of the Affiliated Organization.

ERISA. "ERISA" is the Employee Retirement Income Security Act of 1974, as amended. Any reference to a specific provision of ERISA includes a reference to such provision, any valid ruling, regulation or authoritative pronouncement promulgated thereunder and any provision of future law that amends, supplements or supersedes the provision.

ESOP. The "ESOP" is the portion of the Plan constituting an employee stock ownership plan described in Code section 4975.

ESOP Account. A Participant's "ESOP Account" is that portion of the Participant's Account invested in the Company Stock Fund.

401(k) Contribution Account. The "401(k) Contribution Account" is the account established pursuant to Section 4.1(a)(i).

401(k) Contributions. "401(k) Contributions" means contributions made by Participants pursuant to Section 3.1.

Fund. The "Fund" is the total of all of the assets of every kind and nature, both principal and income, held in the Trust at any particular time or, if the context so requires, one or more of the investment funds described in Section 5.1.

Highly Compensated Employee.

(a) A "Highly Compensated Employee" for any Plan Year is any employee who:

(i) at any time during such Plan Year or the 12-month period preceding such Plan Year, owns or owned (or is considered as owning or having owned within the meaning of Code section 318) more than five percent of the outstanding stock of an Affiliated Organization or stock possessing more than five percent of the total combined voting power of all outstanding stock of an Affiliated Organization; or

(ii) during the 12-month period preceding such Plan Year, received compensation in excess of $80,000 (or such dollar amount, adjusted to reflect increases in the cost of living, as in effect under Code section 414(q)(1)(B) for the calendar year during which the Plan Year in question begins) and is a member of the "Top-Paid Group."

(b) For purposes of this section:

(i) an "employee" is any individual (other than an individual who is a nonresident alien who receives no earned income (within the meaning of Code section 911(d)(2)) from an Affiliated Organization that constitutes income from sources within the United States (within the meaning of Code section 861(a)(3))) who, during the Plan Year for which the determination is being made, performs services for an Affiliated Organization as:

(1) a common-law employee,

(2) an employee pursuant to Code section 401(c)(1) or

(3) a Leased Employee; and

(ii) "compensation" for any period means an employee's Section 415 Wages for the period.

(iii) A former employee of an Affiliated Organization shall be treated as a former Highly Compensated Employee of the Affiliated Organization if

the former employee was a Highly Compensated Employee of the Affiliated Organization when the former employee incurred a Severance from Employment or the former employee was a Highly Compensated Employee of the Affiliated Organization at any time after attaining age 55. The determination of who is a former Highly Compensated Employee is based on the rules applicable to determining Highly Compensated Employee status as in effect for that determination year in accordance with Section 1.414(q)-1T, Q&A-4 of the Temporary Income Tax Regulations and Notice 97-45 or later guidance under the Code.

(iv) "Top-Paid Group" is the group of employees for a particular year which consists of the top 20% of the employer's employees when ranked on the basis of compensation received from the employer during such year, as determined in accordance with Code section 414.

Hour of Active Service. An "Hour of Active Service" is an hour for which the Employee is paid, or entitled to payment, for the performance of duties for an Affiliated Organization.

Hour of Service. An "Hour of Service" shall have the meaning assigned to it in Section 10.5.

Investment Committee. The "Investment Committee" is the Select Comfort Corporation Investment Committee, a committee of members appointed by and serving at the pleasure of the Administrator.

Leased Employee. A "Leased Employee" is any individual (other than an Employee) who provides services for an Affiliated Organization (or for an Affiliated Organization and "related persons" within the meaning of Code section 144(a)(3)):

(a) pursuant to an agreement between an Affiliated Organization and any other person;

(b) under the Affiliated Organization's primary direction and control; and

(c) on a substantially full-time basis for a period of at least one year.

Matching Contribution Account. The "Matching Contribution Account" is the account established pursuant to Section 4.1(a)(ii).

Matching Contributions. "Matching Contributions" means contributions made by the Participating Employers on behalf of Participants pursuant to Section 3.3 or 3.6.

Normal Retirement Age. "Normal Retirement Age" is age 65.

One-Year Break in Service. "One-Year Break in Service" is defined in Section 10.2.

Part-Time Employee. A "Part-Time Employee" is an Employee who is classified by the Participating Employer as regularly scheduled to work less than 30 hours per week.

Participant. A "Participant" is a current or former Qualified Employee who has entered the Plan pursuant to the provisions of Article 2 and who has not ceased to be a Participant pursuant to the provisions of Section 2.8.

Participating Employer. A "Participating Employer" is the Company and any other Affiliated Organization that has adopted the Plan, or all of them collectively, as the context requires, and their respective successors. An Affiliated Organization will cease to be a Participating Employer upon a termination of the Plan as to its Qualified Employees or upon its ceasing to be an Affiliated Organization.

Plan. The "Plan" is that set forth in this instrument as it may be amended from time to time.

Plan Rule. A "Plan Rule" is a rule, policy, practice or procedure adopted by the Administrator.

Plan Year. A "Plan Year" is the 12-month period beginning on each January 1 and ending on the first following December 31.

Profit Sharing Contribution Account. The "Profit Sharing Contribution Account" is the account established pursuant to Section 4.1(a)(iii).

Profit Sharing Contributions. "Profit Sharing Contributions" means contributions made by the Participating Employers on behalf of Participants pursuant to Section 3.4 or 3.6.

Qualified Employee.

(a) Except as provided in subsection (b), a "Qualified Employee" is an Employee who performs services for a Participating Employer as an employee of the Participating Employer (as classified by the Participating Employer at the time the services are performed without regard to any subsequent reclassification).

(b) An Employee who would otherwise be a Qualified Employee is not a Qualified Employee if he or she:

(i) is a nonresident alien who receives no earned income (within the meaning of Code section 911(d)(2)) from a Participating Employer that constitutes income from sources within the United States (within the meaning of Code section 861(a)(3));

(ii) is covered by a collective bargaining agreement, for whom retirement benefits were the subject of good faith bargaining between such person's representative and a Participating Employer, and is not, as a result of such bargaining, specifically covered by this Plan;

(iii) is a Leased Employee; or

(iv) is eligible, or would be eligible but for his or her failure to satisfy any applicable minimum age, minimum service or similar requirement, to

participate in any other qualified defined contribution plan maintained by an Affiliated Organization.

(c) An individual who is classified by a Participating Employer as an independent contractor, Leased Employee or as any other status in which the individual is not classified by the Participating Employer as an Employee of the Participating Employer at the time services are performed is not a Qualified Employee. No judicial or administrative reclassification, or reclassification by the Participating Employer, will be applied to grant retroactive eligibility to any individual under the Plan.

Restatement Date. The "Restatement Date" of the Plan is January 1, 2007.

Rollover Account. The "Rollover Account" is the account established pursuant to Section 4.1(a)(iv).

Section 415 Wages.

(a) An individual's "Section 415 Wages" for any period is his or her "compensation," within the meaning of Code section 415(c)(3) and Treasury Regulations thereunder, for the period from all Affiliated Organizations.

(b) The Administrator may, for any period, determine the items of remuneration that, in accordance with Treasury Regulations, will be included in Section 415 Wages for such period; provided that for each purpose under this Plan, the Administrator's determination will be uniform throughout any period.

(c) An individual's "Section 415 Wages" for any period shall include any elective contributions pursuant to a qualified cash or deferred arrangement, otherwise payable to the individual by an Affiliated Organization, and any other amount that are not includable in an individual's gross income by reason of Code sections 125, 132(f)(4), or 457.

Severance from Employment. A Participant will be deemed to have a "Severance from Employment" only if he or she has completely severed his or her employment relationship with all Affiliated Organizations (meaning the Participant has died, become Disabled or has a "severance from employment" within the meaning of Code section 401(k)(2)(B)(i)(I)). Neither transfer of employment among Affiliated Organizations nor absence from active service by reason of disability leave, other than in connection with a Participant becoming Disabled, or any other leave of absence will constitute a Severance from Employment. A Participant's change in status from an Employee to a Leased Employee will not constitute a Severance from Employment.

Testing Wages.

(a) An individual's "Testing Wages" for any Plan Year is his or her Section 415 Wages for the Plan Year.

(b) Notwithstanding subsection (a), in no event will a person's Testing Wages for any Plan Year be taken into account to the extent it exceeds $200,000, as adjusted for cost-of-living increases in accordance with Code section 401(a)(17)(B). The cost-of-living adjustment in effect for a calendar year applies to Testing Wages for the determination period that begins with or within such calendar year.

(c) The Administrator may, for any Plan Year, adopt any alternative definition of Testing Wages that complies with Code section 414(s) and Treasury Regulations thereunder; provided, that for each purpose under this Plan, the definition so adopted will be uniform throughout any Plan Year.

Treasury Regulations. "Treasury Regulations" mean regulations, rulings, notices and other promulgations issued under the authority of the Secretary of the Treasury that apply to, or may be relied upon in the administration of, this Plan.

Trust. The "Trust" is that created for purposes of implementing benefits under the Plan.

Trustee. The "Trustee" is the corporation and/or individual or individuals who from time to time is or are the duly appointed and acting trustee or trustees of the Trust.

Vesting Service. "Vesting Service" is defined in Section 10.1.

SELECT COMFORT
PROFIT SHARING AND 401(K) PLAN
(2007 Restatement)

EXHIBIT

SERVICE CREDIT AND SPECIAL ENTRY DATES

This exhibit specifies grants of pre-acquisition service and special entry dates pursuant to Sections 2.1, 2.3 and 14.1(f) of the Plan.

[Reserved]

EXHIBIT 10.39

9/25/2006

[Portions of this Exhibit have been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with the portions intact has been filed separately with the Securities and Exchange Commission.]

MASTER AGREEMENT

THIS MASTER AGREEMENT, made and entered into this, by and between SELECT COMFORT CORPORATION, a corporation organized and existing under the laws of the state of Minnesota, hereinafter referred to as "Buyer" and XXXXXXXX, organized under the laws of XXXXXXXX, hereinafter referred to as "Seller".

[Portions of this recital have been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with this recital intact has been filed separately with the Securities and Exchange Commission.]

WINTNESS:

WHEREAS, Buyer is a user of the goods hereinafter described and desires to establish a formal relationship for the purchase from Seller of such goods; and

WHEREAS, Seller is the manufacturer and supplier of such goods and is willing to provide and sell them to Buyer, all upon the terms and conditions hereinafter stated.

NOW, THEREFORE, in consideration of the mutual promises and covenants herein set forth, the parties hereby agree as follows:

ARTICLE 1.
DEFINITIONS

For purposes of this Agreement, the following terms, word and phrases, where written with an initial capital letter, shall have the following meanings:

1.1 "Products" shall mean the air chambers manufactured by Seller according to the Master Specification Exhibit III attached;

1.2 "Improvements" shall mean modifications and/or enhancements to the design of products owned by Buyer, developed by either party during the term of this Agreement as per the Master Specification Exhibit III attached.

ARTICLE 2.
SUPPLY AND PURCHASE

During the term of this Agreement, Buyer agrees to purchase from Seller, and Seller agrees to supply to Buyer, at the prices determined in accordance herewith, and subject to the terms and conditions hereinafter set forth, the annual minimum volumes of Products set forth in Exhibit IV as defined by Exhibit III, Master Specification attached hereto from Seller

2.1 Seller agrees that all air chamber "Products", as specified in Exhibit III, shall be delivered exclusively to Buyer or a company designated by the Buyer. All inquiries that Seller receives on a worldwide basis relative to Buyer's air chamber "Products" as specified in Exhibit III, shall be directed to Buyer.

ARTICLE 3.
ORDERS, DELIVERY AND MODIFICATION OF PRODUCTS

3.1 Purchase Orders. Buyer shall submit purchase orders for the Products a minimum of 14 days prior to the requested delivery date. The delivery date is the date the order is expected to leave the factory en-route to the FOB point. Seller shall advise within 2 business days of receipt of the order if they are unable to fulfill the order as requested. All purchase orders shall be mutually executed in accordance with the terms and conditions of this Agreement and at the prices established herein.

3.2 Delivery of Products. Seller shall deliver the Products within the times specified on the individual purchase orders, in the quantities specified on the individual purchase orders and at the prices specified herein, all in accordance with Buyer's instructions and Master Specifications (Exhibit III). Buyer reserves the right to adjust the mix of the product with a minimum of 14 days notice from the requested delivery date.

3.3 Stock outs: Buyer shall reserve the right to assert claims for actual costs incurred due to the Seller's failure to deliver the product against a confirmed purchase order on the confirmed ship date. All claims shall be submitted in writing to the Seller and accompanied with supporting documentation. Seller may reserve the right to have the claim audited by an independent 3rd party. This claim shall include, but not be limited to, the following costs: expedited freight, in-bound and out-bound, sales lost due to Buyer's inability to meet the 7-10 day delivery commitment to our Customers, or any additional handling or overtime costs incurred as a result of the late delivery.

3.4 Shipping Terms. The initial shipping term for Products delivered by Seller to Buyer pursuant to this agreement shall be the shipping term set forth in

Exhibit I. Such shipping term may be changed by the parties upon mutual agreement in

writing at any time during the term of this agreement. The shipping terms stipulated by the Parties shall be interpreted in accordance with the terms of the Incoterm 2000 defined by the International Chamber of Commerce. In the event of a change in the shipping term, the parties shall adjust the prices for Products set forth in Exhibit I to reflect the changed shipping term.

3.5 Packaging and shipping will be done according to the Master Specification (Exhibit III) and Buyers instructions that will be in conformity with the other paragraphs of the Agreement.

ARTICLE 4.
QUALITY OF PRODUCTS

The quality of all Products delivered by Seller shall be in accordance with the Quality Requirements and Acceptance Criteria, Exhibit II.

ARTICLE 5.
COOPERATION

The parties agree to cooperate in value engineering and product development efforts relating to quality improvement and cost reduction of the Products. Such efforts shall take the form and extent as mutually agreed to by the parties in writing. A cost sharing formula for any savings achieved by these efforts shall be mutually determined and the unit pricing established under Exhibit I shall be revised accordingly to reflect such savings. It is Buyer's expectation that the Seller take a lead role in investigating and presenting new material and process improvements in the air chamber technology.

ARTICLE 6.
PRICES AND PAYMENT

Prices and Adjustments. The pricing to be paid by the Buyer for the Products purchased hereunder shall be the prices set forth in Exhibit I attached hereto. In addition to any changes to such prices pursuant to Paragraph 3.4, such prices may be subject to adjustments as agreed to by the parities. A minimum of 60 days written notice is required prior to the effective date of the requested price adjustment. The adjusted price shall be guaranteed for a minimum of 6 (six) months from the effective date of the price adjustment. Such adjusted prices shall be substituted for the prices set forth in Exhibit I, and a new Exhibit I, as so modified shall be attached to this Agreement.

6.1 Payment Terms. Payment for delivered Products shall be made via a wire transfer by Buyer in United States Dollars thirty (30) days from the date of the Bill of Lading for Products ordered and delivered. Such payment terms may be changed by the parties upon mutual agreement in writing at any time during the term of this agreement.

6.2 Late Payments. If the Buyer is in delay of payment to the Seller, Seller reserves the right to assert a claim to the buyer for interest incurred at the rate of 0.05% per day for each day payment is delayed beyond the original due date of the invoice.

6.2.1 In the event that payment is delayed beyond 30 days from the original due date of the invoice, Supplier reserves the right to withhold confirmed shipments to the Buyer until payment for outstanding invoices is received by the Seller.

ARTICLE 7.
TAXES

Except as otherwise provided in this Agreement Seller shall be responsible for and shall pay any and all (a) export duties, (b) gross receipt, income and pre-sale taxes and (c) other governmental charges which relate to the production, delivery and sale of the Products, as such are now or may hereafter be imposed under or by any state, local or municipal governmental authority or agency in the XXXXXXXX. Seller shall not be responsible and shall not pay any taxes or charges as outlined in above levied after delivery to Buyer.

[A portion of this Article has been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with this Article intact has been filed separately with the Securities and Exchange Commission.]

ARTICLE 8.
ACCEPTANCE AND WARRANTY

8. Buyer shall accept all Product that meets the Select Comforts Air Chamber, Rubber/Cotton Vulcanized, Test and Inspection Specification SP-004, conducted at the Seller site prior to shipment to Buyer. Buyer may forego inspection at the point of receipt or in-coming and/or in-process quality acceptance tests at the time the products are being prepared for shipment to Buyer's customers at its principal place(s) of business in Minneapolis, Minnesota; Irmo, South Carolina; and, Salt Lake City, Utah. Buyer and Seller shall agree to a quality discount percentage that will be applied to invoices at the time the Product ships from the Seller to Buyer. This quality discount XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXX. The quality discount will be reviewed at least every XXXXXX and adjusted based on the last XXXXXX activity. A review of the quality discount will be warranted prior to

XXXXXX in the event the quality discount average varies more than XXXXXX from the established quality discount over any XXXXXX period. In the event of a change in the quality discount, Exhibit II will be updated to reflect the revised quality discount.

[A portion of this Article has been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with this Article intact has been filed separately with the Securities and Exchange Commission.]

8.1.1. Seller warrants to the Buyer from the date of delivery of the Products to the Buyer in accordance with Section 3.2 of this Agreement that all Products sold hereunder shall (i) be free from any defects in material or workmanship and be of good and merchantable quality, (ii) conform to Buyer's specifications to any sample or prototype approved by Buyer and (iii) comply and have been produced, processed and delivered in conformity with Article 4 herein for the period defined in the warranty schedule contained in Exhibit II, Quality Requirements and Acceptance.

8.1.2. The foregoing warranties shall survive inspection of, delivery of and payment for the Products and shall run in favor of Buyer and its customers. If Seller breaches any of the foregoing warranties during the term of the warranty period specified in Exhibit II, or if Seller fails to perform or comply with any provision of this Agreement, Seller shall be liable to Buyer for any and all costs, expenses (including reasonable attorneys' fees, court costs and litigation expenses) and damages arising therefrom.

ARTICLE 9.
PROPRIETARY RIGHTS

9.1 Buyer retains all proprietary rights in and to all designs of the air chambers, as specified in the Master Specification, Exhibit III. The Seller agrees to continuously undertake efforts concerning the quality improvements of the Products taking into consideration the market requirements and the economical production.

9.2 The Seller agrees to continue to make process and development improvements to the product according to special requests made by Buyer. Such improvements are made for consideration on basis of mutual written agreements of the parties. The costs of these development activities are to be borne as agreed upon in writing by both parties prior to the actual development activities.

9.3 Seller retains all proprietary rights in and to all engineering details and other data pertaining to its manufacturing technology and processes.

ARTICLE 10.
TRADEMARKS

Nothing contained in the Agreement will be deemed to grant either party any right or interest in the trademarks, trade name, service marks, proprietary words, or symbols which the other may have adopted or used at any time in the course of its business.

ARTICLE 11.
CONFIDENTIALITY

Each party agrees that all information disclosed to it or any of its affiliates by other, whether verbally or in writing, shall be presumed to be proprietary and confidential to such party, unless otherwise stated in writing. Each party shall prevent the disclosure of any such proprietary information in strictest confidence absent service of compulsory process. Each party shall not during the term of this Agreement or thereafter, use any such proprietary information for any purpose other than as specifically set forth in the Agreement.

ARTICLE 12.
COMPETITIVE ACTIVITIES

During the term of this Agreement, Seller will not participate in the management or operations of any enterprise engaged in activities in competition with the business of Buyer.

ARTICLE 13.
TERM AND TERMINATION

13.1 Term of Agreement. This agreement shall take effect as of the date hereof and shall continue in full force and effect for a period of (5) years and thereafter shall be automatically renewed for successive terms of (1) one year each. Either party may provide written notice to the other party at least 365 days prior to the expiration of the initial term or any renewal term of its desire not to renew this Agreement upon the expiration of the relevant term.

13.2 Termination. This Agreement may be terminated only in accordance with the following provisions:

13.2.1 This Agreement may be terminated at any time upon the mutual written consent of the parties hereto;

13.2.2 Either party hereto may terminate this Agreement by giving notice in writing to the other party in the event that the other party is in material breach of this Agreement and shall have failed to cure such breach within (30) thirty days of receipt of written notice thereof from the first party specifying the nature of the breach; or

13.2.3 Either party hereto may terminate this Agreement at any time by giving notice in writing to the other party, if (1) the other party at any time (i) file or have filed against it a petition of any type as to its bankruptcy, (ii) be adjudged bankrupt or insolvent, (iii) make and assignment for the benefit of its creditors, or (iv) go into liquidation receivership; (2) a trustee, receiver or other equivalent officer is appointed for the other party by any

court or governmental authority or any third party to administrator or liquidate, who is not dismissed within (60) sixty days of the date of appointment; or (3) dissolution proceedings are commenced by or against the other party, which are not dismissed within (60) sixty days of commencement.

13.2.4 This Agreement may be terminated by Buyer or Seller with a minimum of (365) three hundred sixty five days written notice if either party discontinues using the Products in its business.

13.2.5 This Agreement may be terminated by the Buyer with immediate effect upon the Buyer providing the Seller with notice of such termination in the event of any of the following:

a) The Seller fails to meet the quality standards specified in Exhibit II in any material respect for a period of at least 90 consecutive days. The termination right pursuant to this Section 13.2.5(a) shall be exercised as follows. If at any time during the term of this Agreement the Buyer becomes aware of a material failure of the quality standards as specified in Exhibit II, it shall immediately notify the Seller in writing, clearly specifying the failure of quality standards and providing a 90-day period to the Seller for remedy. For the avoidance of any doubt, it is agreed that Exhibit II shall specify which quality failures are considered material. Upon receipt of such written notice from the Buyer, the 90-day period for remedy and improvement in quality commences. If the Seller fails to comply in a material respect with the quality standards specified in Exhibit II within that 90-day period, the Buyer is entitled to serve termination notice pursuant to this Section 13.2.5 upon the lapse of the period;

b) The Seller repeatedly and for a period of at least 60 consecutive days fails to meet the delivery requirements specified in Section 3.2 (and Exhibit III respectively). The termination right pursuant to this Section 13.2.5(b) shall be exercised as follows. If at any time during the term of this Agreement the Buyer becomes aware of a failure of the Seller to meet the respective delivery requirements pursuant to Section 3.2 (and Exhibit III respectively), it shall immediately notify the Seller in writing, clearly specifying the failure of the Seller to meet the delivery requirements and providing a 60-day period to the Seller for remedy. Upon receipt of such written notice from the Buyer, the 60-day period for remedy and improvement in delivery commences. If the Seller fails to meet the delivery requirements specified in Section 3.2 (and Exhibit III respectively) with respect to the supplies provided to the Buyer within that 60-day period, the Buyer is entitled to serve termination notice pursuant to this Section 13.2.5 upon the lapse of the period.

13.2.6 Upon the lapse of three (3) years from the date of conclusion of this Agreement, this Agreement may be terminated by the Buyer with a

minimum of (365) three hundred and sixty-five days' written notice in the event that the Seller ceases to be cost competitive. The termination right pursuant to this Section 13.2.6 can be exercised as follows:

a) If the Buyer obtains at least two (2) legally binding offers from third parties, which are not parties related to the Buyer, offering to supply products (i) identical to the products offered by the Seller; and (ii) under at least equal terms with regard to quality, delivery and volume of supplies for the delivery of the products; and (iii) with at least an equal volume of supplies as anticipated and agreed in Exhibit IV until the end of this Agreement, and (iv) for prices that are at least 10% lower than the prices provided by the Seller. The Buyer shall notify the Seller of any such competitive offers. Upon receipt of such written notice from the Buyer, the Seller shall have a period of 90-days in which to respond with a competitive offer. If the Seller fails to provide or is unable to provide such an offer deemed to be competitive by the Buyer as per the conditions described in this Section 13.2.6.a, the termination right pursuant to Section 13.2.6 may be excercised by the Buyer.

b) It is agreed that the termination notice must contain copies of the offers stipulated in Section 13.2.6.

13.2.7 This Agreement may be terminated by the Buyer or Seller with a minimum of (365) three hundred and sixty-five days' written notice in the event that (i) there is a Change of Control of the Seller or Buyer, and (ii) such Change of Control has Negative Consequence on the respective business of the Buyer or Seller.

a) For the purposes of this Section, the term "Change of Control" means the acquisition by any person or entity or group of affiliated persons or entities of more than twenty-five percent (25%) of the voting rights in the Seller or Buyer respectively. For the purposes of this Section, the term "Negative Consequence" means a situation in which the Change of Control may result in (i) a substantial deterioration in the financial ability of the Seller or Buyer to meet the terms of this Agreement, or (ii) a direct competitor of the Buyer (in the case of a Change of Control of the Seller) becoming an owner or person exercising voting rights in the Seller.

b) Upon the occurrence of a Change of Control, the Seller or Buyer respectively are obliged to notify the other party in writing about the Change of Control, providing, in particular, the details on the person or legal entity taking control within the meaning of a Change of Control. If the Buyer or Seller does not use its right to terminate the Agreement within the period of 30 days after the notification of the Change of

Control, the right to terminate on the basis of the notified Change of Control expires. For the avoidance of any doubt, the termination right pursuant to

this Section 13.2.7 does not arise if the Change of Control is a result of the internal restructuring of the group of the Seller or Buyer respectively.

c) It is agreed that before the Seller or Buyer exercise the right to terminate pursuant to this Section 13.2.7, the parties will exert their best efforts to explain and potentially remedy the potential Negative Consequences which the Change of Control may have on this Agreement.

d) In any event this Agreement can be terminated by Seller of Buyer, with immediate effect upon the Buyer providing the Seller with notice of such termination in the event that the person or legal entity which acquires any share of the voting rights in the Seller or Buyer respectively, is resident in the countries which are listed on the list of US government of the countries [with which the trading is restricted].

13.3 Rights and Obligations on Termination. In the event of the termination of this agreement, the parties hereto shall have the following rights and obligations:

13.3.1 The obligations of Seller and Buyer under the terms of Sections 4, 7, 8, 9, 10 and 11 hereof shall survive the termination of this Agreement.

13.3.2 Within (20) twenty days after the termination of this Agreement, each party shall either return to the other any and all proprietary or provide a written certification of destruction of such confidential information in its possession or under its control.

13.3.3 Termination or expiration of this Agreement shall not release either party from the obligation to make payment to the other party of all amounts then and thereafter due payable under this Agreement within (30) thirty days of termination.

ARTICLE 14.
FORCE MAJEURE

14.1 Definition. Force Majeure shall mean any event or condition, not existing as of the date of signature of this Agreement, not reasonably foreseeable as of such date and not reasonably within the control of either party, which prevents in whole or in material part the performance of such obligations so difficult or costly as to make such performance commercially unreasonable. Without limiting the foregoing, the following shall constitute events or conditions of Force Majeure: acts of State or, governmental action, riots, disturbance, war, strikes, lockouts, slowdowns, prolonged shortage of energy supplies, epidemics, fire, flood, hurricane, typhoon, earthquake, lightning and explosion.

14.2 Notice. Upon giving notice to the other party, a party affected by an event of Force Majeure shall be released without any liability on its part from the performance of its obligations under this Agreement, except for the obligation to

pay any amounts due and owing hereunder, but only to the extent and only for the period that its performance of such obligations is prevented by the event of Force Majeure. Such notice shall include a description of the nature of the event of Force Majeure, its cause and possible consequences. The party claiming Force Majeure shall promptly notify the other party to the terminations of such event.

14.3 Suspension of Performance. During the period that the performance by one of the parties of its obligations under this Agreement has been suspended by reason of an event of Force Majeure, the other party may likewise suspend the performance of all or part of its obligations hereunder.

ARTICLE 15.
DISPUTES AND GOVERNING LAW

15.1 Disputes. The parties hereto shall submit any disputes arising under this Agreement to arbitration. Such arbitration proceedings shall be conducted in English and shall be carried on in the city of Vienna, Austria or any other place mutually agreeable to the Parties, under the UNCITRAL Arbitration Rules. Judgement upon the award rendered by the arbitrator in favor of the prevailing party, which shall include an award for the payment of costs, attorneys' fees and expenses of the arbitration proceedings, may be entered in any court of competent jurisdiction and assets may be attached in any country in the world pursuant to such judgement.

ARTICLE 16.
GENERAL TERMS AND CONDITIONS

16.1 Relationship. This Agreement does not make either party hereto the employee, agent or legal representative of the other party for any purpose whatsoever. Neither party hereto is granted any right or authority to assume or to create any obligation or responsibility, expressed or implied, on behalf of or in the name of the other party. In fulfilling its obligations pursuant to the Agreement, each party hereto shall act as an independent contractor.

16.2 Assignment. Each party shall not assign or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the other party. This Agreement and the rights and obligation arising hereunder shall not be affected by any change in the corporate structure of ownership of the parties.

16.3 Notices. All notices permitted or required to be given hereunder shall be delivered personally or sent by telecopy or registered or certified air mail, postage prepaid, return receipt requested, addressed to the addresses of the parties hereto as set forth above or to such other addresses as the given parties may designate by like notice from time to time. Notices so given shall be effective (a) upon the date of personal delivery, (b) if sent by telecopy, concurrently with the transmission thereof if the sender's machine produces a transmission report without notice of a

communication fault, (c) on the (3rd) third business day following the date on which such notice is mailed by registered or certified air mail.

16.4 Entire Agreement. This Agreement, including the Exhibits attached hereto and by this reference made an integral part hereof, constitute the entire agreement of the parties hereto with respect to the subject matter hereof and thereof, and supersede all previous proposals, verbal or written, expressed or implied, and all negotiations, conversations or discussions heretofore between the parties hereto related to the subject matter of this Agreement.

16.5 Amendment. This Agreement shall not be deemed or construed to be modified, amended, rescinded, canceled or waived, in whole or in part, except by written statement signed by both parties hereto.

16.6 Severability. In the event that any of the terms of this Agreement are in conflict with any rule of law or statutory provision or otherwise unenforceable under the laws or regulations of any government or subdivision thereof, such terms shall be deemed stricken from this Agreement, but such invalidity or unenforceability of any such provisions hereof does substantial violence to, or where the invalid or unenforceable provisions comprise an integral part of, or otherwise inseparable from, the remainder of this Agreement.

16.7 Compliance with Applicable Laws. The parties to this Agreement shall at all times conduct their activities hereunder in accordance with all applicable federal, state and local laws, rules and governmental regulations.

16.8 Waiver. No failure by either party hereto to take any action or assert any right hereunder shall be deemed to be a waiver of such right in the event of the continuation or repetition of the circumstances giving rise to such right.

16.9 Counterparts. This Agreement may be executed in (2) two or more counterparts in the English language, each of which shall be deemed an original, but all of which shall constitute (1) one and the same instrument.

16.10 Remedies Cumulative. Each of the right and remedies of the parties set forth in this Agreement shall be cumulative with all other rights and remedies, as well as with all rights and remedies of the partied hereto otherwise available at law or in equity.

16.11 Indemnification. Each party shall indemnify the other and hold it harmless from and against any and all costs including reasonable attorneys' fees, court costs and litigation expenses, losses, expenses and damages incurred by the other party in connection with any claim or cause of action brought by any third person or part against it which, in whole or in part is based upon or arises out of any breach of any of its obligations hereunder.

16.12 Captions. The captions of Articles and Sections of this Agreement are included for convenient reference only, shall not be construed as part of this Agreement and shall not be used to define, limit, extend or interpret the terms hereof.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on the day and year first written above.

SELECT COMFORT CORPORATION	XXXXXXXXX
By /s/ XXXXXXXXX	By /s/ XXXXXXXXX
Title VP Supply Chain	Title Vice Chairman of Board of Directors
Date: 9/25/06	Date: 3.10.06

9/25/2006

EXHIBIT I

Product Part Number, Description, and Pricing

The following prices shall be in effect from January 1, 2007 through December 31, 2009 providing that the Buyer comply the volume requirements and/or that the parties mutually agree to change the minimum volume requirements in accordance with Exhibit IV. These prices shall be valid for 2010 and 2011 only for the volumes in the amount of XXXXXX pcs in 2010 and in the amount of XXXXXX pcs in 2011. In case the Buyer shall take delivery of the goods in 2010 and 2011 above XXXXXX pcs in 2010 and XXXXXX pcs in 2011, the prices for this over-production shall be stipulated by the Parties based on the deviation between up-to-date exchange rate in the given year, and the basic exchange rate which was used for the determination of below mentioned prices on the level of 1.00 USD = XXXXXX. Prices below are shown in USD.

Part Number	Description	2006 Prices	2007 – 2009 Prices	2010 – 2011 Prices
100133	Mini	XXXXX	XXXXX	XXXXX
100270	Twin	XXXXX	XXXXX	XXXXX
100271	Full	XXXXX	XXXXX	XXXXX
100272	Single Queen	XXXXX	XXXXX	XXXXX
100273	Dual Queen	XXXXX	XXXXX	XXXXX
100274	Eastern King	XXXXX	XXXXX	XXXXX
100275	Cal King	XXXXX	XXXXX	XXXXX
100276	TXL	XXXXX	XXXXX	XXXXX
100277	Super Single	XXXXX	XXXXX	XXXXX
100278	Super Queen	XXXXX	XXXXX	XXXXX
100279	Super King	XXXXX	XXXXX	XXXXX
100281	Euro	XXXXX	XXXXX	XXXXX
105757	Expanded Queen	XXXXX	XXXXX	XXXXX
105758	Cosmetic Twin	XXXXX	XXXXX	XXXXX
105759	Cosmetic Full	XXXXX	XXXXX	XXXXX
105760	Cosmetic Dual Queen	XXXXX	XXXXX	XXXXX
105761	Cosmetic Eastern King	XXXXX	XXXXX	XXXXX
106433	Grand King	XXXXX	XXXXX	XXXXX
106811	TXL Dual Inlet	XXXXX	XXXXX	XXXXX
106812	Single Queen Dual Inlet	XXXXX	XXXXX	XXXXX
106813	Dual Queen Dual Inlet	XXXXX	XXXXX	XXXXX
106814	Exp Queen Dual Inlet	XXXXX	XXXXX	XXXXX
106815	Eastern King Dual Inlet	XXXXX	XXXXX	XXXXX
106816	Cal King Dual Inlet	XXXXX	XXXXX	XXXXX
107099	Sleeper Sofa	XXXXX	XXXXX	XXXXX
107173	Grand King Dual Inlet	XXXXX	XXXXX	XXXXX
107325	FXL	XXXXX	XXXXX	XXXXX

9/25/2006

108050	Cosmetic Exp Queen	XXXXX	XXXXX	XXXXX
108051	Cosmetic Cal King	XXXXX	XXXXX	XXXXX

Delivery/Shipping Terms
FOB German – Bremerhaven or Hamburg Ocean Port, full 20’ or 40’ container delivered

Prices are determined and valid in relation to volumes said in EXHIBIT IV.

Both parties reserve the right to open price negotiations as per Article 6 of the long term Agreement in case of considerable change of prices of basic materials, energy, fuels, and transport costs.

[A portion of this Exhibit I has been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with the portions intact has been filed separately with the Securities and Exchange Commission.]

EXHIBIT II

Quality Requirements and Acceptance Criteria

The Buyers engineering specifications and engineering drawing requirements take precedence over other requirements communicated to the Seller, whether such requirements are verbal or written, except where a Deviation From Specification (DFS) is approved and issued to the Seller by the Buyer.

The Seller shall review pre-production, prototype, first-piece, sample, or other initial part or product, with the Buyer. This review shall include representative samples, process data, and inspection and test data, for the purpose of determining if the part or product meets the Buyers engineering specifications and engineering drawing requirements, as well as safety and other regulatory requirements specific to the part or product supplied.

Either Seller or Buyer may initiate a DFS where there is a realized need to depart from requirements documented within the Buyers engineering specifications or engineering drawings.

The Seller shall review known part or product deficiencies with the Buyer prior to shipping the part or product to the Buyer. In some instances, Buyer may approve a DFS to allow the Seller to produce deficient parts or products for a limited period of time, or to ship a limited quantity of parts or products exhibiting a known deficiency.

Seller disputes concerning requirements, or whether part or product meets the Buyers engineering specifications or engineering drawing requirements, shall be reviewed and mediated by the Buyers representatives from the Quality Control, Manufacturing Engineering, R&D, and Supply Chain Management departments.

The Seller shall install appropriate controls and methods to ensure the part or product supplied meets the Buyers engineering specifications and engineering drawing requirements upon final delivery to the Buyer. Seller controls shall be considered for, but not limited to, operations within raw material receiving, work-in-process, finished goods, packaging, and shipping.

Buyer may, at any point, reject part or product that does not meet the Buyers engineering specifications, engineering drawing requirements, or deviated requirements (per an approved and issued DFS). This shall include at the receiving, storage, value-added operations, packaging, shipping, or customer service stages of Buyer’s use, and/or sale of the supplied part or product.

Rejected part or product shall be reviewed by the Buyer with the Seller for the purpose of making a disposition of the part or product. The Seller shall have the opportunity to review rejected part or product, and to dispute the determination of rejection.

Where a rejection is found to be valid, the Seller shall perform an analysis of the part, product, process, or other element within the Seller’s scope of operations, as necessary, and issue a report of corrective action to the Buyer.

The Seller shall allow buyer representatives to discuss, review, inspect, measure, test, or otherwise evaluate part or product issues with Seller representatives within the Seller’s manufacturing facility(ies), at a Buyer’s facility, or at a mutually agreed upon location. Upon suitable notification to the Seller, Buyer shall be allowed to verify compliance with this agreement, and to perform on-site audits of the Seller’s manufacturing processes related to part or product as specified and purchased by the Buyer.

Seller efforts to improve, cost-reduce, boost efficiencies, or otherwise change the part, product, or the process originally agreed to, shall be reviewed in advance with the Buyer, whether or not this activity has any affect or influence on the part or product meeting the Buyer’s engineering specifications or engineering drawing requirements.

The Seller shall review plans to subcontract to another corporate entity, any part or product the Buyer has contracted with the Seller to supply. This review shall be completed prior to any such subcontracting, and shall include the review and approval by the buyer of the Seller’s quality plan for the subcontracted part or

product. In some instances, Buyer will require first piece samples, including inspection and test data, from the subcontractor prior to approval of part or product manufactured by the subcontractor. In any event, the Seller shall remain fully and completely responsible for supplying the part or product to the Buyer's engineering specification and engineering drawing requirements.

All air chamber testing shall be in accordance with Select Comfort's Air Chamber, Rubber/Cotton Vulcanized Construction, Test and Inspection Specification SP-004.

Quality Discount percentage: as of September 2006 is XXXXX and shall remain in effect as outlined in Article 8.

Warranty Schedule:

January 1, 2006 and beyond	60 Month warranty period

[A portion of this Exhibit II has been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with the portions intact has been filed separately with the Securities and Exchange Commission.]

9/25/2006

EXHIBIT III
Master Specifications
(master files)

[The entire contents of this Exhibit III have been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with the contents intact has been filed separately with the Securities and Exchange Commission.]

9/25/2006

Exhibit IV (Revised September 2006)
Forecasted Volume

Fiscal Year	Volume **(range of +/- 10%)**
2007	XXXXXXX
2008	XXXXXXX
2009	XXXXXXX
2010	XXXXXXX
2011	XXXXXXX

Best effort will be made to submit standard purchase orders that represent 12 equal monthly quantities plus or minus XXXXXXX in any given month.

Fiscal Year means the twelve-month period from January 1 through December 31.

Any changes to the volumes represented above shall be mutually agreed to with a minimum of three months notice prior to the requested change date.

This September 2006 revision to the exhibit reflects previously provided volume information for the years 2007-2009.

XXXXXXX has requested longer term outlook to include 2010- 2011. The figures included for these years above are estimated only based on assumed continued linear growth of XXXXXXX per calendar year XXXXXXX using the revised 2007 figures as the baseline, and should be considered informational only for the purpose requested, and should not be considered firm annual volumes or commitment .

By:_____
Title:_____
Date:_____

[A portion of this Exhibit IV has been omitted pursuant to a request for confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. A copy of this Exhibit with the portions intact has been filed separately with the Securities and Exchange Commission.]

EXHIBIT 21.1

SUBSIDIARIES OF SELECT COMFORT CORPORATION

Name of Subsidiary	Organized under the Laws of
Select Comfort Retail Corporation	Minnesota (USA)
Select Comfort Direct Corporation	Minnesota (USA)
Select Comfort SC Corporation	Minnesota (USA)
Select Comfort Canada Holding Inc.	Minnesota (USA)
selectcomfort.com corporation	Minnesota (USA)
Select Comfort Wholesale Corporation	Minnesota (USA)
Select Comfort Canada ULC	Alberta, Canada
Select Comfort COSC Canada ULC	Alberta, Canada
Select Comfort Limited	United Kingdom

EXHIBIT 23.1

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Select Comfort Corporation:

We consent to the incorporation by reference in the registration statements on Form S-8 (No. 333-70493, No. 333-79157, No. 333-74876, No. 333-84329, No. 333-80755, No. 333-85914 and No. 333-118329) of Select Comfort Corporation and subsidiaries of our reports dated February 26, 2007, with respect to the consolidated balance sheets of Select Comfort Corporation as of December 30, 2006 and December 31, 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 30, 2006, and the related financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting as of December 30, 2006 and the effectiveness of internal control over financial reporting as of December 30, 2006, which reports appear in the December 30, 2006 annual report on Form 10-K of Select Comfort Corporation.

Our report dated February 26, 2007 notes that the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, on January 1, 2006.

KPMG LLP

Minneapolis, Minnesota
February 26, 2007

EXHIBIT 31.1

Certification by Chief Executive Officer

I, William R. McLaughlin, certify that:

1. I have reviewed this annual report on Form 10-K of Select Comfort Corporation;

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) 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 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 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: February 27, 2007

/s/ William R. McLaughlin
William R. McLaughlin
Chairman and Chief Executive Officer

EXHIBIT 31.2

Certification by Chief Financial Officer

I, James C. Raabe, certify that:

1. I have reviewed this annual report on Form 10-K of Select Comfort Corporation;

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) 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 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 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: February 27, 2007

/s/ James C. Raabe
James C. Raabe
Senior Vice President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Select Comfort Corporation (the "Company") on Form 10-K for the fiscal year ended December 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, William R. McLaughlin, Chairman and Chief Executive Officer of the Company, solely for the purposes of 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, does hereby certify, to his knowledge, 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.

Date: February 27, 2007

/s/ William R. McLaughlin
William R. McLaughlin
Chairman and Chief Executive Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Select Comfort Corporation (the "Company") on Form 10-K for the fiscal year ended December 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, James C. Raabe, Senior Vice President and Chief Financial Officer of the Company, solely for the purposes of 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, does hereby certify, to his knowledge, 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.

Date: February 27, 2007

/s/ James C. Raabe
James C. Raabe
Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.