

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 27, 2020

OR

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

Commission File Number: 000-25121



SLEEP NUMBER CORPORATION

(Exact name of registrant as specified in its charter)

Minnesota
(State or other jurisdiction of incorporation or organization)

41-1597886
(I.R.S. Employer Identification No.)

1001 Third Avenue South
Minneapolis, Minnesota
(Address of principal executive offices)

55404
(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	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	SNBR	Nasdaq Global Select Market

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes NO

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 27, 2020, 27,725,000 shares of the registrant's Common Stock were outstanding.

**SLEEP NUMBER CORPORATION
AND SUBSIDIARIES
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PART I: FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(unaudited - in thousands, except per share amounts)

	June 27, 2020	December 28, 2019
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,651	\$ 1,593
Accounts receivable, net of allowance for doubtful accounts of \$957 and \$898, respectively	15,754	19,978
Inventories	81,674	87,065
Prepaid expenses	12,072	15,335
Other current assets	30,607	36,397
Total current assets	141,758	160,368
Non-current assets:		
Property and equipment, net	186,943	197,421
Operating lease right-of-use assets	315,221	327,017
Goodwill and intangible assets, net	74,109	73,226
Other non-current assets	50,767	48,011
Total assets	\$ 768,798	\$ 806,043
Liabilities and Shareholders' Deficit		
Current liabilities:		
Borrowings under credit facility	\$ 227,240	\$ 231,000
Accounts payable	94,966	134,594
Customer prepayments	51,235	34,248
Accrued sales returns	17,196	19,809
Compensation and benefits	33,067	40,321
Taxes and withholding	21,085	22,171
Operating lease liabilities	60,180	59,561
Other current liabilities	57,547	53,070
Total current liabilities	562,516	594,774
Non-current liabilities:		
Deferred income taxes	8,191	3,808
Operating lease liabilities	286,292	298,090
Other non-current liabilities	74,817	68,802
Total liabilities	931,816	965,474
Shareholders' deficit:		
Undesignated preferred stock; 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.01 par value; 142,500 shares authorized, 27,725 and 27,961 shares issued and outstanding, respectively	277	280
Additional paid-in capital	5,519	—
Accumulated deficit	(168,814)	(159,711)
Total shareholders' deficit	(163,018)	(159,431)
Total liabilities and shareholders' deficit	\$ 768,798	\$ 806,043

See accompanying notes to condensed consolidated financial statements.

**SLEEP NUMBER CORPORATION
AND SUBSIDIARIES**
Condensed Consolidated Statements of Operations
(unaudited - in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Net sales	\$ 284,938	\$ 355,963	\$ 757,504	\$ 782,408
Cost of sales	121,928	138,777	292,363	302,989
Gross profit	163,010	217,186	465,141	479,419
Operating expenses:				
Sales and marketing	130,165	168,839	337,909	355,666
General and administrative	36,716	33,045	67,788	67,368
Research and development	8,254	8,057	18,755	16,433
Total operating expenses	175,135	209,941	424,452	439,467
Operating (loss) income	(12,125)	7,245	40,689	39,952
Interest expense, net	3,940	3,228	6,284	5,837
(Loss) income before income taxes	(16,065)	4,017	34,405	34,115
Income tax (benefit) expense	(3,435)	(263)	7,895	4,417
Net (loss) income	\$ (12,630)	\$ 4,280	\$ 26,510	\$ 29,698
Basic net (loss) income per share:				
Net (loss) income per share – basic	\$ (0.45)	\$ 0.14	\$ 0.95	\$ 0.98
Weighted-average shares – basic	27,923	29,873	27,890	30,247
Diluted net (loss) income per share:				
Net (loss) income per share – diluted	\$ (0.45)	\$ 0.14	\$ 0.93	\$ 0.95
Weighted-average shares – diluted	27,923	30,531	28,523	31,134

See accompanying notes to condensed consolidated financial statements.

**SLEEP NUMBER CORPORATION
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Condensed Consolidated Statements of Shareholders' Deficit
(unaudited - in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount			
Balance at December 28, 2019	27,961	\$ 280	\$ —	\$ (159,711)	\$ (159,431)
Net income	—	—	—	39,140	39,140
Exercise of common stock options	167	1	3,282	—	3,283
Stock-based compensation	396	4	2,047	—	2,051
Repurchases of common stock	(888)	(9)	(5,329)	(35,614)	(40,952)
Balance at March 28, 2020	27,636	\$ 276	\$ —	\$ (156,185)	\$ (155,909)
Net loss	—	—	—	(12,630)	(12,630)
Exercise of common stock options	33	—	817	—	817
Stock-based compensation	71	1	5,032	—	5,033
Repurchases of common stock	(15)	—	(330)	1	(329)
Balance at June 27, 2020	27,725	\$ 277	\$ 5,519	\$ (168,814)	\$ (163,018)

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount			
Balance at December 29, 2018	30,868	\$ 309	\$ —	\$ (109,859)	\$ (109,550)
Net income	—	—	—	25,418	25,418
Exercise of common stock options	151	2	2,834	—	2,836
Stock-based compensation	364	3	3,635	—	3,638
Repurchases of common stock	(1,170)	(12)	(6,469)	(40,501)	(46,982)
Balance at March 30, 2019	30,213	\$ 302	\$ —	\$ (124,942)	\$ (124,640)
Net income	—	—	—	4,280	4,280
Exercise of common stock options	115	1	2,158	—	2,159
Stock-based compensation	99	1	4,249	—	4,250
Repurchases of common stock	(1,104)	(11)	(6,407)	(36,933)	(43,351)
Balance at June 29, 2019	29,323	\$ 293	\$ —	\$ (157,595)	\$ (157,302)

See accompanying notes to condensed consolidated financial statements.

**SLEEP NUMBER CORPORATION
AND SUBSIDIARIES**
Condensed Consolidated Statements of Cash Flows
(unaudited - in thousands)

	Six Months Ended	
	June 27, 2020	June 29, 2019
Cash flows from operating activities:		
Net income	\$ 26,510	\$ 29,698
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	30,811	31,187
Stock-based compensation	7,084	7,888
Net loss (gain) on disposals and impairments of assets	224	(431)
Deferred income taxes	4,383	721
Changes in operating assets and liabilities:		
Accounts receivable	4,224	5,214
Inventories	5,391	(2,977)
Income taxes	2,508	(9,195)
Prepaid expenses and other assets	7,018	(8,580)
Accounts payable	(14,804)	12,408
Customer prepayments	16,987	3,407
Accrued compensation and benefits	(7,405)	2,348
Other taxes and withholding	(3,594)	(1,836)
Other accruals and liabilities	7,664	495
Net cash provided by operating activities	87,001	70,347
Cash flows from investing activities:		
Purchases of property and equipment	(21,695)	(33,896)
Proceeds from sales of property and equipment	25	2,571
Purchase of intangible assets	(945)	—
Net cash used in investing activities	(22,615)	(31,325)
Cash flows from financing activities:		
Repurchases of common stock	(41,774)	(99,684)
Net (decrease) increase in short-term borrowings	(26,364)	56,758
Proceeds from issuance of common stock	4,100	4,995
Debt issuance costs	(290)	(1,019)
Net cash used in financing activities	(64,328)	(38,950)
Net increase in cash and cash equivalents	58	72
Cash and cash equivalents, at beginning of period	1,593	1,612
Cash and cash equivalents, at end of period	\$ 1,651	\$ 1,684

See accompanying notes to condensed consolidated financial statements.

**SLEEP NUMBER CORPORATION
AND SUBSIDIARIES**
Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Business and Summary of Significant Accounting Policies

Business & Basis of Presentation

We prepared the condensed consolidated financial statements as of and for the three and six months ended June 27, 2020 of Sleep Number Corporation and our 100%-owned subsidiaries (Sleep Number or the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and they reflect, in the opinion of management, all normal recurring adjustments necessary to present fairly our financial position as of June 27, 2020 and December 28, 2019, and the consolidated results of operations and cash flows for the periods presented. Our historical and quarterly consolidated results of operations may not be indicative of the results that may be achieved for the full year or any future period. Additionally, based on the duration and severity of the current global situation involving the novel coronavirus (COVID-19) pandemic, including but not limited to general economic conditions, consumer confidence, store closings mandated by federal, state or local authorities and possible supply chain disruptions, the extent to which COVID-19 will impact our business and our consolidated financial results will depend on future developments, which are highly uncertain and cannot be predicted.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with our most recent audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 28, 2019 and other recent filings with the SEC.

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of sales, expenses and income taxes during the reporting period. Predicting future events is inherently an imprecise activity and, as such, requires the use of judgment. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. In addition, during the current environment involving COVID-19, predicting future events will be especially challenging for management. Changes in these estimates will be reflected in the consolidated financial statements in future periods and could be material. Our critical accounting policies consist of stock-based compensation, goodwill and indefinite-lived intangible assets, warranty liabilities and revenue recognition.

The condensed consolidated financial statements include the accounts of Sleep Number Corporation and our 100%-owned subsidiaries. All significant intra-entity balances and transactions have been eliminated in consolidation.

New Accounting Pronouncements

Recently Adopted Accounting Guidance

In April 2020, the Financial Accounting Standards Board (FASB) issued a Staff Q&A, *Topic 842 and 840: Accounting For Lease Concessions Related to the Effects of the COVID-19 Pandemic*. To provide clarity in response to the COVID-19 pandemic crisis, the FASB staff believes that it would be acceptable for entities to make an election to account for lease concessions related to the effects of the COVID-19 pandemic consistent with how those concessions would be accounted for under Topic 842 as though enforceable rights and obligations for those concessions existed (regardless of whether those enforceable rights and obligations for the concessions explicitly exist in the contract).

Consequently, for concessions related to the effects of the COVID-19 pandemic, we will not have to analyze each contract to determine whether enforceable rights and obligations for concessions exist in the contract and can elect to apply or not apply the lease modification guidance in Topic 842 to those contracts. This election is available for concessions related to the effects of the COVID-19 pandemic that do not result in a substantial increase in the rights of the lessor or our obligations as the lessee. For example, this election is available for concessions that result in the total payments required by the modified contract being substantially the same as or less than total payments required by the original contract. The FASB staff expects that reasonable judgment will be exercised in making those determinations. Some concessions will provide a deferral of payments with no substantive changes to the consideration in the original contract. A deferral affects the timing, but the amount of the consideration is substantially the same as that required by the original contract. The staff expects that there will be multiple ways to account for those deferrals, none of which the staff believes are more preferable than the others. Two of those methods are:

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- a. Account for the concessions as if no changes to the lease contract were made. Under that accounting, a lessor would increase its lease receivable, and a lessee would increase its accounts payable as receivables/payments accrue. In its income statement, a lessor would continue to recognize income, and a lessee would continue to recognize expense during the deferral period.
- b. Account for the deferred payments as variable lease payments.

We adopted option a. above and continue to recognize rent expense on a straight-line basis. We deferred approximately \$5 million in rent cash payments from the second quarter of fiscal 2020 to future periods, including \$3.5 million of rent payments related to leases where we have a signed agreement related to the deferrals and the remainder related to leases we are still in the process of negotiating with the lessors. See Note 6. *Leases*, for further information.

2. Fair Value Measurements

At June 27, 2020 and December 28, 2019, we had \$10 million and \$8 million, respectively, of debt and equity securities that fund our deferred compensation plan and are classified in other non-current assets. We also had corresponding deferred compensation plan liabilities of \$10 million and \$8 million at June 27, 2020 and December 28, 2019, respectively, which are included in other non-current liabilities. The majority of the debt and equity securities are Level 1 as they trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. Unrealized gains/(losses) on the debt and equity securities offset those associated with the corresponding deferred compensation plan liabilities.

3. Inventories

Inventories consisted of the following (in thousands):

	June 27, 2020	December 28, 2019
Raw materials	\$ 7,662	\$ 6,231
Work in progress	86	31
Finished goods	73,926	80,803
	<u>\$ 81,674</u>	<u>\$ 87,065</u>

4. Goodwill and Intangible Assets, Net

Goodwill and Indefinite-Lived Intangible Assets

Goodwill was \$64 million at June 27, 2020 and December 28, 2019. Indefinite-lived trade name/trademarks totaled \$1.4 million at June 27, 2020 and December 28, 2019.

Definite-Lived Intangible Assets

Developed Technologies

The gross carrying amount of our developed technologies was \$19 million at June 27, 2020 and December 28, 2019. Accumulated amortization was \$12 million and \$11 million at June 27, 2020 and December 28, 2019, respectively.

Amortization expense for both the three months ended June 27, 2020 and June 29, 2019, was \$0.5 million. Amortization expense for the six months ended June 27, 2020 and June 29, 2019, was \$1.1 million.

Other

In June 2020, we purchased certain other definite-lived intangible assets for a total purchase price of \$2 million and will amortize them over an average of nine years. Amortization expense for the three and six months ended June 27, 2020 was not significant.

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Annual amortization for definite-lived intangible assets for subsequent years are as follows (in thousands):

2020 (excluding the six months ended June 27, 2020)	\$	1,238
2021		2,403
2022		2,403
2023		1,431
2024		222
2025		226
Thereafter		743
Total future amortization for definite-lived intangible assets	\$	<u>8,666</u>

5. Credit Agreement

Our credit facility as of June 27, 2020, had a total commitment amount of \$525 million. The credit facility is for general corporate purposes and to meet our seasonal working capital requirements. The credit agreement provides the lenders with a collateral security interest in substantially all of our assets and those of our subsidiaries and requires us to comply with, among other things, a maximum leverage ratio (4.5x) and a minimum interest coverage ratio (3.0x). Under the terms of the credit agreement, we pay a variable rate of interest and a commitment fee based on our leverage ratio. The credit agreement matures in February 2024. We were in compliance with all financial covenants as of June 27, 2020.

On April 3, 2020, we amended the credit agreement to add a 364-day term loan facility up to an aggregate commitment of \$75 million under our credit agreement for a total commitment amount of \$525 million, with an additional \$75 million remaining available under our accordion (subject to lenders' approval). We fully drew down the term loan and secured an initial interest rate of approximately 3.27%, which was equal to the one-month LIBOR rate plus the applicable margin based on the then-current total leverage ratio. In addition, the amendment: (a) increases the floor for loans based on LIBOR to at least 0.75% and (b) prohibits the use of proceeds of the revolving loan, term loan or letters of credit under the credit agreement, as amended, to make capital distributions (as defined in the credit agreement, as amended, to include, among other items, dividends and share repurchases). No financial covenants were amended. The additional borrowings were undertaken as a precautionary measure to provide increased liquidity and preserve financial flexibility in light of disruption and uncertainty resulting from the COVID-19 pandemic. Proceeds may be used in the future for working capital and other general corporate purposes permitted by the credit agreement, as amended.

The following table summarizes our borrowings under the credit facility (\$ in thousands):

	June 27, 2020	December 28, 2019
Outstanding borrowings ⁽¹⁾	\$ 227,240	\$ 231,000
Outstanding letters of credit	\$ 3,997	\$ 3,497
Additional borrowing capacity	\$ 293,763	\$ 215,503
Weighted-average interest rate	3.0 %	3.5 %

⁽¹⁾ Outstanding borrowings at June 27, 2020 include the \$75 million term loan due April 2, 2021.

6. Leases

We lease our retail, office and manufacturing space under operating leases which, in addition to the minimum lease payments, may require payment of a proportionate share of the real estate taxes and certain building operating expenses. While our local market development approach generally results in long-term participation in given markets, our retail store leases generally provide for an initial lease term of five to 10 years. Our office and manufacturing leases provide for an initial lease term of up to 15 years. In addition, our mall-based retail store leases may require payment of variable rent based on net sales in excess of certain thresholds. Certain leases may contain options to extend the term of the original lease. The exercise of lease renewal options is at our sole discretion. Lease options are included in the lease term only if exercise is reasonably certain at lease commencement. Our lease agreements do not contain any material residual value guarantees. We also lease vehicles and certain equipment under operating leases with an initial lease term of three to five years.

Our operating lease costs include facility, vehicle and equipment lease costs, but exclude variable lease costs. Operating lease costs are recognized on a straight-line basis over the lease term, after consideration of rent escalations and rent holidays. The lease term for

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purposes of the calculation begins on the earlier of the lease commencement date or the date we take possession of the property. During lease renewal negotiations that extend beyond the original lease term, we estimate straight-line rent expense based on current market conditions. Variable lease costs are recorded when it is probable the cost has been incurred and the amount can be reasonably estimated. Future payments for real estate taxes and certain building operating expenses for which we are obligated are not included in operating lease costs.

At June 27, 2020, our finance right-of-use assets and lease liabilities were not significant.

Operating lease costs were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Operating lease costs ⁽¹⁾	\$ 22,357	\$ 21,079	\$ 45,303	\$ 42,136
Variable lease costs	\$ 263	\$ 423	\$ 275	\$ 921

⁽¹⁾ Includes short-term lease costs which are not significant.

The maturities of operating lease liabilities as of June 27, 2020, were as follows⁽¹⁾ (in thousands):

2020 (excluding the six months ended June 27, 2020)	42,344
2021	79,043
2022	70,634
2023	60,697
2024	48,887
2025	40,043
Thereafter	92,379
Total lease payments ⁽²⁾	434,027
Less: Interest	87,555
Present value of operating lease liabilities ⁽³⁾	<u>\$ 346,472</u>

⁽¹⁾ We deferred certain lease payments initially due in the second quarter of fiscal 2020 to future periods. These deferred rent payments of \$5 million are excluded from this table and are included in Other current liabilities. See Note 1, *Business and Summary of Significant Accounting Policies, New Accounting Pronouncements, Recently Adopted Accounting Guidance*.

⁽²⁾ Total lease payments exclude \$53 million of legally binding minimum lease payments for leases signed but not yet commenced.

⁽³⁾ Includes the current portion of \$60 million for operating lease liabilities.

Other information related to operating leases was as follows:

	June 27, 2020	December 28, 2019
Weighted-average remaining lease term (years)	6.5	6.6
Weighted-average discount rate	7.1 %	7.2 %

(in thousands)	Six Months Ended	
	June 27, 2020	June 29, 2019
Cash paid for amounts included in present value of operating lease liabilities	\$ 42,773	\$ 39,941
Right-of-use assets obtained in exchange for operating lease liabilities	\$ 17,670	\$ 36,543

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(unaudited)

7. Repurchases of Common Stock

Repurchases of our common stock were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Amount repurchased under Board-approved share repurchase program	\$ —	\$ 40,000	\$ 38,111	\$ 80,900
Amount repurchased in connection with the vesting of employee restricted stock grants	329	3,351	3,170	9,433
Total amount repurchased (based on trade dates)	<u>\$ 329</u>	<u>\$ 43,351</u>	<u>\$ 41,281</u>	<u>\$ 90,333</u>

As of June 27, 2020, the remaining authorization under our Board-approved share repurchase program was \$437 million.

In light of the uncertainty surrounding the impact of COVID-19, we have suspended all share repurchases under our Board-approved share repurchase program.

8. Revenue Recognition

Deferred contract assets and deferred contract liabilities are included in our condensed consolidated balance sheets as follows (in thousands):

	June 27, 2020	December 28, 2019
Deferred Contract Assets included in:		
Other current assets	\$ 23,448	\$ 23,568
Other non-current assets	34,678	33,782
	<u>\$ 58,126</u>	<u>\$ 57,350</u>
Deferred Contract Liabilities included in:		
Other current liabilities	\$ 32,423	\$ 34,204
Other non-current liabilities	45,732	44,970
	<u>\$ 78,155</u>	<u>\$ 79,174</u>

During the three months ended June 27, 2020 and June 29, 2019, we recognized revenue of \$10 million and \$8 million, respectively, that were included in the deferred contract liability balances at the beginning of the respective periods. During the six months ended June 27, 2020 and June 29, 2019, we recognized revenue of \$18 million and \$17 million, respectively, that were included in the deferred contract liability balances at the beginning of the respective periods.

Revenue from goods and services transferred to customers at a point in time accounted for approximately 97% of our revenues for the three and six months ended June 27, 2020 and approximately 98% of our revenues for the three and six months ended June 29, 2019.

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Net sales were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Retail	\$ 205,759	\$ 327,999	\$ 641,116	\$ 720,225
Online and phone	78,462	25,412	114,379	55,175
Total Retail	284,221	353,411	755,495	775,400
Wholesale/Other	717	2,552	2,009	7,008
Total Company	\$ 284,938	\$ 355,963	\$ 757,504	\$ 782,408

Obligation for Sales Returns

The activity in the sales returns liability account was as follows (in thousands):

	Six Months Ended	
	June 27, 2020	June 29, 2019
Balance at beginning of year	\$ 19,809	\$ 19,907
Additions that reduce net sales	30,901	37,543
Deductions from reserves	(33,514)	(39,684)
Balance at end of period	\$ 17,196	\$ 17,766

9. Stock-Based Compensation Expense

Total stock-based compensation expense was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Stock awards	\$ 4,440	\$ 3,696	5,846	\$ 6,729
Stock options	593	554	1,238	1,159
Total stock-based compensation expense ⁽¹⁾	5,033	4,250	7,084	7,888
Income tax benefit	1,218	1,066	1,714	1,964
Total stock-based compensation expense, net of tax	\$ 3,815	\$ 3,184	\$ 5,370	\$ 5,924

⁽¹⁾ Changes in 2020 stock-based compensation expense reflect the cumulative impact of the change in the expected achievements of certain performance targets.

10. Profit Sharing and 401(k) Plan

Under our 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 pay period, we may make a discretionary contribution equal to a percentage of the employee's contribution. During the three months ended June 27, 2020 and June 29, 2019, our contributions, net of forfeitures, were \$0.5 million and \$1.5 million, respectively. During the six months ended June 27, 2020 and June 29, 2019, our contributions, net of forfeitures, were \$2.1 million and \$3.0 million, respectively.

Effective May 2020 due to the business impact of the COVID-19 pandemic, we temporarily suspended making discretionary 401(k) plan contributions.

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(unaudited)

11. Net (Loss) Income per Common Share

The components of basic and diluted net (loss) income per share were as follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Net (loss) income	\$ (12,630)	\$ 4,280	\$ 26,510	\$ 29,698
Reconciliation of weighted-average shares outstanding:				
Basic weighted-average shares outstanding	27,923	29,873	27,890	30,247
Dilutive effect of stock-based awards	—	658	633	887
Diluted weighted-average shares outstanding	27,923	30,531	28,523	31,134
Net (loss) income per share – basic	\$ (0.45)	\$ 0.14	\$ 0.95	\$ 0.98
Net (loss) income per share – diluted	\$ (0.45)	\$ 0.14	\$ 0.93	\$ 0.95

For the three months ended June 27, 2020, potentially dilutive stock-based awards have been excluded from the calculation of diluted weighted-average shares outstanding, as their inclusion would have had an anti-dilutive effect on our net loss per diluted share. For the three months ended June 29, 2019 and the six months ended June 27, 2020 and June 29, 2019, anti-dilutive stock-based awards excluded from the diluted net income per share calculations were immaterial.

12. Commitments and Contingencies*Warranty Liabilities*

The activity in the accrued warranty liabilities account was as follows (in thousands):

	Six Months Ended	
	June 27, 2020	June 29, 2019
Balance at beginning of year	\$ 11,345	\$ 10,389
Additions charged to costs and expenses for current-year sales	4,965	5,003
Deductions from reserves	(4,789)	(5,591)
Changes in liability for pre-existing warranties during the current year, including expirations	(89)	1,418
Balance at end of period	\$ 11,432	\$ 11,219

Legal Proceedings

We are involved from time to time in various legal proceedings arising in the ordinary course of our business, including primarily commercial, product liability, employment and intellectual property claims. In accordance with U.S. generally accepted accounting principles, we record a liability in our consolidated financial statements with respect to any of these matters when it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. If a material loss is reasonably possible but not known or probable, and may be reasonably estimated, the estimated loss or range of loss is disclosed. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible material losses either because we believe that we have valid defenses to claims asserted against us, the proceeding has not advanced to a stage of discovery that would enable us to establish an estimate, or the potential loss is not material. We currently do not expect the outcome of pending legal proceedings to have a material effect on our consolidated results of operations, financial position or cash flows. Litigation, however, is inherently unpredictable, and it is possible that the ultimate outcome of one or more claims asserted against us could adversely impact our consolidated results of operations, financial position or cash flows. We expense legal costs as incurred.

On September 18, 2018, two former Home Delivery team members filed suit, now venued in San Diego County Superior Court, California, alleging representative claims on a purported class action basis under the California Labor Code Private Attorney General Act. While the two representative plaintiffs were in the Home Delivery workforce, the Complaint does not limit the purported plaintiff class to that group. The plaintiffs allege that Sleep Number failed or refused to adopt adequate practices, policies and procedures relating to wage payments, record keeping, employment disclosures, meal and rest breaks, among other claims, under California law.

**SLEEP NUMBER CORPORATION
AND SUBSIDIARIES**
Notes to Condensed Consolidated Financial Statements
(unaudited)

The Complaint sought damages in the form of civil penalties and plaintiffs' attorneys' fees. The parties have executed a settlement agreement pending Court approval, which includes the settlement and release of certain additional related claims that are contained in a consolidated complaint. We intend to continue vigorously defending this matter in the event the Court does not approve the settlement.

On March 27, 2018, Level Sleep, LLC (Level Sleep) filed a patent infringement lawsuit against Sleep Number in the Federal District Court for the Eastern District of Texas. In its Complaint, Level Sleep claims that Sleep Number infringed two patents owned by Level Sleep, U.S. Patent Nos. 6,807,698 and 7,036,172 (the Patents), by, among other things, making, using, offering for sale, or selling within the United States, and/or importing into the United States, beds with sleep surfaces having foam with multiple zones in the longitudinal direction. Level Sleep has asserted that five non-360® beds no longer sold and two current non-360 beds infringe the Patents. Level Sleep seeks damages in the form of a reasonable royalty. Sleep Number has asserted that the Patents are invalid and that our products do not infringe the Patents. On January 14, 2020, the Court granted summary judgment in favor of Sleep Number, finding that Sleep Number's products do not infringe the Patents. Level Sleep has filed an appeal of the Court's summary judgment order. We intend to continue vigorously defending this matter.

13. COVID-19 Pandemic

The COVID-19 pandemic and ensuing government restrictions resulted in the temporary closure of 47% of retail stores on average during the three months ended June 27, 2020. More than 95% of our stores were open as of June 27, 2020. The pandemic has adversely impacted our revenue growth and our financial performance. The length and severity of the reduction in consumer demand due to the pandemic and the impact on our future financial performance remains uncertain.

In response to the pandemic, we have taken decisive actions to focus on the health and safety of our team members and customers, strengthening our liquidity, cash flows and financial position, and mitigating the future impact on our operations and financial performance. See Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations* and Part II: Item 1A. *Risk Factors* for additional discussion on the COVID-19 pandemic and the impact on our business.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide a reader of our condensed consolidated financial statements with a narrative from the perspective of management on our financial condition, results of operations, liquidity and certain other factors that may affect our future results. Our MD&A is presented in eight sections:

- Risk Factors
- Business Overview
- COVID-19 Pandemic - Impact on our Business
- Results of Operations
- Liquidity and Capital Resources
- Non-GAAP Data Reconciliations
- Off-Balance-Sheet Arrangements and Contractual Obligations
- Critical Accounting Policies

Forward-Looking Statements and Risk Factors

The discussion in this Quarterly 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:

- *Current and future general and industry economic trends and consumer confidence;*
- *Risks inherent in outbreaks of pandemics or contagious disease, including the COVID-19 pandemic;*
- *The effectiveness of our marketing messages;*
- *The efficiency of our advertising and promotional efforts;*
- *Our ability to execute our Total Retail distribution strategy;*
- *Our ability to achieve and maintain acceptable levels of product and service quality, and acceptable product return and warranty claims rates;*
- *Our ability to continue to improve and expand our product line, and consumer acceptance of our products, product quality, innovation and brand image;*
- *Industry competition, the emergence of additional competitive products and the adequacy of our intellectual property rights to protect our products and brand from competitive or infringing activities;*
- *Claims that our products, processes, advertising, or trademarks infringe the intellectual property rights of others;*
- *Availability of attractive and cost-effective consumer credit options;*
- *Our manufacturing processes with minimal levels of inventory, which may leave us vulnerable to shortages in supply;*
- *Our dependence on significant suppliers and third parties and our ability to maintain relationships with key suppliers or third-parties, including several sole-source suppliers or providers of services;*
- *Rising commodity costs and other inflationary pressures;*
- *Risks inherent in global sourcing activities, including tariffs, outbreaks of pandemics or contagious diseases, strikes and the potential for shortages in supply;*
- *Risks of disruption in the operation of any of our main manufacturing facilities or assembly facilities;*
- *Increasing government regulation;*
- *Pending or unforeseen litigation and the potential for adverse publicity associated with litigation;*
- *The adequacy of our and third-party information systems to meet the evolving needs of our business and existing and evolving risks and regulatory standards applicable to data privacy and security;*
- *The costs and potential disruptions to our business related to upgrading our information systems;*
- *The vulnerability of our and third-party information systems to attacks by hackers or other cyber threats that could compromise the security of our systems, result in a data breach or disrupt our business; and*
- *Our ability to attract, retain and motivate qualified management, executive and other key team members, including qualified retail sales professionals and managers.*

Additional information concerning these, and other risks and uncertainties is contained under the caption "Risk Factors" below in Part II: Item 1A of this Quarterly Report on Form 10-Q and under the same caption in our Annual Report on Form 10-K.

We have no obligation to publicly update or revise any of the forward-looking statements contained in this Quarterly Report on Form 10-Q.

Business Overview

As a purpose driven company in health and wellness, Sleep Number is the leader in sleep innovation. Our vertically integrated business model and role as the exclusive designer, manufacturer, marketer, retailer and servicer of Sleep Number® beds allows us to offer consumers high-quality, individualized sleep solutions and services.

We generate revenue by marketing our innovations to new and existing customers, and selling products through Total Retail and Wholesale/Other. Total Retail, which includes Stores, Online, Chat and Phone, sells directly to consumers. Wholesale/Other sells to and through selected wholesale customers in the United States.

We are committed to delivering superior shareholder value by: (1) increasing consumer demand; (2) leveraging our business model; and (3) deploying capital efficiently.

COVID-19 Pandemic - Impact on our Business

The COVID-19 pandemic and ensuing government restrictions resulted in the temporary closure of 47% of our retail stores on average during the three months ended June 27, 2020. More than 95% of our stores were open as of June 27, 2020. The pandemic has adversely impacted our revenue and overall financial performance. The length and severity of the reduction in consumer demand due to the pandemic and the impact on our future financial performance remains uncertain. See Part II: Item 1A. *Risk Factors* for further discussion of the adverse impacts of the COVID-19 pandemic on our business.

In response to the pandemic, we have prioritized the health and safety of our team members, serving our customers and ensuring business continuity. We have taken decisive actions to strengthen our liquidity, cash flows and financial position, and to mitigate the future impact on our operations and financial performance. These measures include, but are not limited to, the following:

Health and Safety of our Team Members and Customers. Upon onset of the COVID-19 pandemic, we have implemented precautionary and sanitary guidelines throughout our operations, including stores, manufacturing, home delivery and headquarters based on the Centers for Disease Control and Prevention's (CDC) recommendations.

Expense Management. With the reduction in revenue growth due to the pandemic, we have, and will continue to implement appropriate cost cutting actions as needed, including:

- In April 2020, we furloughed nearly 40% of our team members with another 30% working reduced hours. The majority of our team members returned to work as stores reopened and customer demand increased during the quarter. In response to changes in the business, we have restructured some teams, which resulted in less than 10% of positions being eliminated from across the country as we reallocated headcount to support the changing needs of our business.
- A significant amount of our team members' compensation depends on Company performance against predetermined goals and changes in shareholder value. Our CEO will not receive any cash compensation for the balance of the year through a 50% deferral and exchanging all remaining salary for restricted stock units. In addition, our board and most of our leadership team reduced their cash compensation in exchange for restricted stock units. All team members' cash compensation has been meaningfully reduced to-date through variable compensation programs and other actions.
- We temporarily suspended our 401(k) match and selected other employee benefit programs.
- We reduced our sales and marketing expenses, and halted most discretionary projects across the company.
- We negotiated rent deferrals and abatements for stores closed due to COVID-19.

Liquidity, Cash Flows and Financial Position. We have taken the following actions to preserve cash, increase liquidity and strengthen our financial position:

- Added \$75 million of additional liquidity on April 3, 2020 through an incremental 364-day term loan under our credit facility's \$150 million accordion.
- Suspended share repurchases under our Board-approved share repurchase program for the remainder of 2020.
- Reduced capital expenditures to \$22 million for the six months ended June 27, 2020, compared with \$34 million during the comparable period one year ago.
- Net liquidity available under our credit facility was \$294 million at June 27, 2020 - \$129 million greater than one year ago.
- Our leverage ratio as defined in our credit agreement was 2.8x as of June 27, 2020. The maximum leverage ratio under our credit agreement is 4.5x.

CARES Act. On March 27, 2020, the President signed the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) into law. The CARES Act includes the following relief, among others:

- Amended federal tax laws to permit 100% bonus depreciation for eligible qualified improvement property placed in service by the taxpayer after December 31, 2017 and before January 1, 2023.
- Employers are eligible for a 50 percent refundable payroll tax credit on wages paid up to \$10,000, per employee, during the crisis. The credit would be available to employers whose businesses were disrupted due to virus shutdowns and those that had a decrease in gross receipts of 50 percent or more when compared to the same quarter last year. The credit can be claimed for employees who are retained but not currently working due to the crisis for firms with more than 100 employees.
- Provides for deferred payment of the employer portion of social security taxes through the end of 2020, with 50% of the deferred amount due December 31, 2021 and the remaining 50% due December 31, 2022. This will provide us with additional liquidity during 2020.

Results of Operations

Quarterly and Year-to-Date Results

Quarterly and year-to-date operating results may fluctuate significantly as a result of a variety of factors, including increases or decreases in sales, timing, amount and effectiveness of advertising expenditures, changes in sales return rates or warranty experience, timing of investments in growth initiatives and infrastructure, timing of store openings/closings and related expenses, changes in net sales resulting from changes in our store base, timing of new product introductions and related expenses, timing of promotional offerings, competitive factors, changes in commodity costs, disruptions in supplies or third-party service providers, seasonality of retail and bedding industry sales, consumer confidence and general economic conditions. In addition, based on the duration and severity of the current global situation involving the COVID-19 pandemic, the extent to which our business and our condensed consolidated financial results are impacted, will depend on future developments, which are highly uncertain and cannot be predicted. Therefore, our historical results of operations may not be indicative of the results that may be achieved for any future period.

Highlights

Financial highlights for the three months ended June 27, 2020 were as follows:

- The COVID-19 pandemic and ensuing government restrictions resulted in the temporary closure of 47% of our retail stores on average during the three months ended June 27, 2020. We took decisive action to manage liquidity and costs through the challenging economic environment caused by the COVID-19 pandemic. For additional details, see "COVID-19 Pandemic - Impact on our Business" above.
- As of June 27, 2020, more than 95% of our stores were open.
- Net sales for the three months ended June 27, 2020 decreased 20% to \$285 million, compared with \$356 million for the same period one year ago.
- The 20% net sales decrease was due to a 21% comparable sales decrease in Total Retail, partially offset by 1 percentage point (ppt.) of sales growth from net new stores opened in the past 12 months. For additional details, see the components of total net sales change on page 17.
- Sales per store (sales for stores open at least one year, Total Retail, including online and phone sales) on a trailing twelve-month basis for the period ended June 27, 2020 totaled \$2.8 million, 1% higher than the same period last year.
- As part of our efforts to navigate the uncertainties of the COVID-19 pandemic, we reduced operating expenses 17%, or \$35 million, to \$175 million, compared with \$210 million in the prior-year period while continuing to support our innovation initiatives.
- Operating loss for the three months ended June 27, 2020 was \$12 million, a decrease of \$19 million, compared with operating income of \$7 million in the prior-year period.
- The operating loss for the three months ended June 27, 2020 resulted from the 20% decrease in net sales and a 3.8 ppt. decrease in the gross profit rate. The 3.8 ppt. gross profit rate decrease was primarily due to two factors: (i) an unfavorable sales mix of lower-margin products driven primarily by an increase to 28% of sales from online, phone and chat compared with 7% in the prior-year period; and (ii) deleverage from the 20% net sales decrease, including the associated operational inefficiencies.
- During the three months ended June 27, 2020, we continued to prioritize investments in near- and long-term growth drivers, including \$8.3 million of R&D expenses that support our innovation strategy. In addition, during the three months ended June 27, 2020, we purchased a patent portfolio to further strengthen our competitive position related to the cooling and heating of beds and bedding.

- Net loss for the three months ended June 27, 2020 was \$13 million, compared with net income of \$4 million for the same period one year ago. Net loss per diluted share was \$0.45, compared with net income per diluted share of \$0.14 last year.
- Cash provided by operating activities for the six months ended June 27, 2020 increased by \$17 million, or 24%, to \$87 million, compared with \$70 million for the same period one year ago.
- Cash and cash equivalents at June 27, 2020 totaled \$2 million. At June 27, 2020, we had \$227 million of borrowings under our credit facility, including the \$75 million 364-day term loan which we added on April 3, 2020. Net liquidity available under our credit facility was \$294 million at June 27, 2020.

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

	Three Months Ended				Six Months Ended			
	June 27, 2020		June 29, 2019		June 27, 2020		June 29, 2019	
Net sales	\$ 284.9	100.0 %	\$ 356.0	100.0 %	\$ 757.5	100.0 %	\$ 782.4	100.0 %
Cost of sales	121.9	42.8 %	138.8	39.0 %	292.4	38.6 %	303.0	38.7 %
Gross profit	163.0	57.2 %	217.2	61.0 %	465.1	61.4 %	479.4	61.3 %
Operating expenses:								
Sales and marketing	130.2	45.7 %	168.8	47.4 %	337.9	44.6 %	355.7	45.5 %
General and administrative	36.7	12.9 %	33.0	9.3 %	67.8	8.9 %	67.4	8.6 %
Research and development	8.3	2.9 %	8.1	2.3 %	18.8	2.5 %	16.4	2.1 %
Total operating expenses	175.1	61.5 %	209.9	59.0 %	424.5	56.0 %	439.5	56.2 %
Operating (loss) income	(12.1)	(4.3 %)	7.2	2.0 %	40.7	5.4 %	40.0	5.1 %
Interest expense, net	3.9	1.4 %	3.2	0.9 %	6.3	0.8 %	5.8	0.7 %
(Loss) income before income taxes	(16.1)	(5.6 %)	4.0	1.1 %	34.4	4.5 %	34.1	4.4 %
Income tax (benefit) expense	(3.4)	(1.2 %)	(0.3)	(0.1 %)	7.9	1.0 %	4.4	0.6 %
Net (loss) income	\$ (12.6)	(4.4 %)	\$ 4.3	1.2 %	\$ 26.5	3.5 %	\$ 29.7	3.8 %
Net (loss) income per share:								
Basic	\$ (0.45)		\$ 0.14		\$ 0.95		\$ 0.98	
Diluted	\$ (0.45)		\$ 0.14		\$ 0.93		\$ 0.95	
Weighted-average number of common shares:								
Basic	27.9		29.9		27.9		30.2	
Diluted	27.9		30.5		28.5		31.1	

The percentage of our total net sales, by dollar volume, was as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Total Retail	99.7 %	99.3 %	99.7 %	99.1 %
Wholesale/Other	0.3 %	0.7 %	0.3 %	0.9 %
Total Company	100.0 %	100.0 %	100.0 %	100.0 %

The components of total net sales change, including comparable net sales changes, were as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Sales change rates:				
Retail comparable-store sales ⁽¹⁾	(40 %)	9 %	(14 %)	7 %
Online and phone	209 %	2 %	107 %	4 %
Total Retail comparable sales change ⁽¹⁾	(21 %)	8 %	(5 %)	7 %
Net opened/closed stores	1 %	5 %	2 %	4 %
Total Retail	(20 %)	13 %	(3 %)	11 %
Wholesale/Other	(72 %)	(44 %)	(71 %)	(23 %)
Total Company net sales change	(20 %)	13 %	(3 %)	11 %

⁽¹⁾ Stores are included in the comparable-store calculations in the 13th full month of operations. Stores that have been remodeled or repositioned within the same shopping center remain in the comparable-store base.

Other sales metrics were as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Average sales per store ⁽¹⁾ (\$ in thousands)	\$ 2,830	\$ 2,800		
Average sales per square foot ⁽¹⁾	\$ 988	\$ 1,015		
Stores > \$2 million in net sales ⁽²⁾	63 %	69 %		
Stores > \$3 million in net sales ⁽²⁾	25 %	28 %		
Average revenue per mattress unit ⁽³⁾	\$ 4,767	\$ 4,945	\$ 4,839	\$ 4,868

⁽¹⁾ Trailing-twelve months Total Retail comparable sales per store open at least one year.

⁽²⁾ Trailing-twelve months for stores open at least one year (excludes online and phone sales).

⁽³⁾ Represents Total Retail net sales divided by Total Retail mattress units.

The number of retail stores operating was as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Beginning of period	611	585	611	579
Opened	6	17	14	32
Closed	(19)	(8)	(27)	(17)
End of period	598	594	598	594

Comparison of Three Months Ended June 27, 2020 with Three Months Ended June 29, 2019**Net sales**

Net sales for the three months ended June 27, 2020 decreased by \$71 million, or 20%, to \$285 million, compared with \$356 million for the same period one year ago. The COVID-19 pandemic and ensuing government restrictions resulted in the temporary closure of 47% of our retail stores on average during the three months ended June 27, 2020. More than 95% of our stores were open as of June 27, 2020. For additional details, see "COVID-19 Pandemic - Impact on our Business" above.

The 20% net sales decrease consisted of a 21% comparable sales decrease in Total Retail partially offset by 1 percentage point (ppt.) of sales growth from net new stores opened in the past 12 months. For additional details, see the components of total net sales change on page 17.

The \$71 million net sales decrease compared with the same period one year ago was comprised of the following: (i) a \$70 million decrease in our Total Retail comparable net sales; and (ii) a \$2 million decrease in Wholesale/Other sales; partially offset by (iii) a \$1 million increase resulting from net store openings. Total Retail mattress unit sales decreased 17% compared with the prior year. Total Retail average revenue per mattress unit was \$4,767, a 4% decrease compared with \$4,945 in the prior-year period.

Gross profit

Gross profit of \$163 million decreased by \$54 million, or 25%, compared with \$217 million for the same period one year ago. The gross profit rate decreased to 57.2% of net sales for the three months ended June 27, 2020, compared with 61.0% for the prior-year comparable period. The current-year gross profit rate decrease of 3.8 ppt. was mainly due to two factors that resulted from the pandemic's disruption on our business: (i) an unfavorable sales mix of lower-margin products (2.6 ppt.) driven primarily by an increase to 28% of net sales generated from online, phone and chat compared with 7% in the prior-year period (for the six months ended June 27, 2020, 15% of net sales were generated from online, phone and chat compared with 7% in the prior-year period); and (ii) deleverage from the 20% net sales decrease, including the associated operational inefficiencies (1.2 ppt.). In addition, our gross profit rate will fluctuate from quarter to quarter due to a variety of other factors, including return and exchange costs, and performance-based incentive compensation.

Sales and marketing expenses

Sales and marketing expenses for the three months ended June 27, 2020 were \$130 million, or 45.7% of net sales, compared with \$169 million, or 47.4% of net sales, for the same period one year ago. The \$39 million decrease was primarily due to the decisive actions we took to manage expenses in response to the COVID-19 pandemic and the ensuing government restrictions that resulted in the temporary closure of most of our stores. These actions included reducing media expenses by 34% compared with the same period last year and controlling payroll costs via furloughs and reduced team members' hours. The sales and marketing expense rate decreased by 1.7 ppt. in the current-year period, compared with the same period one year ago due to the items discussed above; partially offset by the deleveraging impact of the 20% net sales decrease.

General and administrative expenses

General and administrative (G&A) expenses totaled \$37 million, or 12.9% of net sales, for the three months ended June 27, 2020, compared with \$33 million, or 9.3% of net sales, in the prior-year period. The \$3.7 million increase in G&A expenses consisted primarily of: (i) a \$5.0 million increase in broad-participation performance-based incentive compensation (in the first quarter of 2020 no performance-based company-wide incentive compensation expense was recorded based on the expected impact the pandemic would have on our 2020 financial performance); and (ii) \$1.0 million of severance costs resulting from the permanent elimination of certain roles due to changing business needs based on the COVID-19 pandemic; partially offset by (iii) a \$2.3 million decrease in travel expenses, professional fees and other expenses. The G&A expense rate increased by 3.6 ppt. in the current-year period, compared with the same period one year ago due to the items discussed above and by the deleveraging impact of the 20% net sales decrease.

Research and development expenses

Research and development (R&D) expenses increased to \$8.3 million for the three months ended June 27, 2020, compared with \$8.1 million for the same period last year as we continued to prioritize our long-term innovation initiatives. The R&D expense rate for the three months ended June 27, 2020 increased to 2.9% of net sales, compared with 2.3% of net sales for the prior year due to the deleveraging impact of the 20% net sales decrease.

Interest expense, net

Interest expense, net increased to \$3.9 million for the three months ended June 27, 2020, compared with \$3.2 million for the same period one year ago. The \$0.7 million increase was mainly driven by a higher level of outstanding borrowings during the three months ended June 27, 2020, compared with the same period one year ago.

Income tax expense

Income tax benefit totaled \$3.4 million for the three months ended June 27, 2020, compared with \$0.3 million last year. The effective income tax rate for the three months ended June 27, 2020 was 21.4%, compared with -6.5% for the comparable period last year, reflecting higher stock-based compensation excess tax benefits in the prior-year period.

Comparison of Six Months Ended June 27, 2020 with Six Months Ended June 29, 2019**Net sales**

Net sales for the six months ended June 27, 2020 decreased by \$25 million, or 3%, to \$758 million, compared with \$782 million for the same period one year ago. The COVID-19 pandemic and ensuing government restrictions resulted in the temporary closure of most of our retail stores starting in mid-March, with 47% of our stores closed on average during the three months ended June 27, 2020. More than 95% of our stores were open as of June 27, 2020. For additional details, see "COVID-19 Pandemic - Impact on our Business" above.

The 3% net sales decrease consisted of a 5% comparable sales decrease in Total Retail partially offset by 2 percentage points (ppt.) of sales growth from net new stores opened in the past 12 months. For additional details, see the components of total net sales change on page 17.

The \$25 million net sales decrease compared with the same period one year ago was comprised of the following: (i) a \$40 million decrease in our Total Retail comparable net sales; and (ii) a \$5 million decrease in Wholesale/Other channel sales; partially offset by (iii) a \$20 million increase resulting from net store openings. Total Retail mattress unit sales decreased 2%, compared with the prior year. Average revenue per mattress unit in Total Retail was \$4,839, a 1% decrease, compared with \$4,868 in the prior-year period.

Gross profit

Gross profit of \$465 million decreased by \$14 million, or 3%, compared with \$479 million for the same period one year ago. The gross profit rate was 61.4% of net sales for the six months ended June 27, 2020, compared with 61.3% for the prior-year comparable period. The current-year gross profit rate was relatively consistent with the prior year as the gross profit rate improvement realized in the first quarter of 2020 was essentially offset by a reduction in the gross profit rate during the second quarter of 2020 due to the pandemic's disruption on our business (see Gross profit discussion above under Comparison of the Three Months ended June 27, 2020). In addition, our gross profit rate will fluctuate from quarter to quarter due to a variety of other factors, including return and exchange costs, and performance-based incentive compensation.

Sales and marketing expenses

Sales and marketing expenses for the six months ended June 27, 2020 were \$338 million, or 44.6% of net sales, compared with \$356 million, or 45.5% of net sales, for the same period one year ago. The \$18 million decrease was primarily due to the decisive actions we took to manage expenses in response to the COVID-19 pandemic and the ensuing government restrictions that resulted in the temporary closure of most of our stores. These actions resulted in a 7% reduction in media expenses compared with the same period last year (34% reduction in media expenses for the three months ended June 27, 2020) and lower payroll costs due to furloughs and reduced team members' hours. The sales and marketing expense rate decreased by 0.9 ppt. in the current-year period, compared with the same period one year ago due to the items discussed above; partially offset by the deleveraging impact of the 3% net sales decrease.

General and administrative expenses

General and administrative (G&A) expenses totaled \$68 million, or 8.9% of net sales, for the six months ended June 27, 2020, compared with \$67 million, or 8.6% of net sales, in the prior-year period. The \$0.4 million increase in G&A expenses was primarily due to a net increase severance charges recorded in the second quarter arising in response to the COVID-19 pandemic. Team members' compensation expense was consistent on a year-over-year basis. The G&A expense rate increased by 0.3 ppt. in the current-year period, compared with the same period one year ago due to the deleveraging impact of the 3% net sales decrease.

Research and development expenses

Research and development (R&D) expenses increased by 14% to \$19 million for the six months ended June 27, 2020, compared with \$16 million for the same period one year ago. The R&D expense rate for the six months ended June 27, 2020 increased to 2.5% of net sales, compared with 2.1% of net sales for the prior year. The spending level increase supports our ongoing consumer innovation strategy.

Interest expense, net

Interest expense, net increased to \$6.3 million for the six months ended June 27, 2020, compared with \$5.8 million for the same period one year ago. The \$0.4 million increase was mainly driven by an increase in the average borrowings outstanding during the six months ended June 27, 2020, compared with the same period one year ago.

Income tax expense

Income tax expense totaled \$7.9 million for the six months ended June 27, 2020, compared with \$4.4 million last year. The effective income tax rate for the six months ended June 27, 2020 was 22.9%, compared with 12.9% for the comparable period last year, reflecting higher stock-based compensation excess tax benefits in the prior-year period.

Liquidity and Capital Resources

Managing our liquidity and capital resources is an important part of our commitment to deliver superior shareholder value over time. The COVID-19 pandemic and ensuing government restrictions have resulted in the temporary closure of most of our retail stores since mid-March, with 47% of our retail stores on average closed during the three months ended June 27, 2020. More than 95% of our stores were open as of June 27, 2020. We took the following decisive actions to manage liquidity and capital resources through the challenging economic environment caused by the COVID-19 pandemic:

- On April 3, 2020, we added a \$75 million 364-day term loan under our credit agreement for a total commitment amount of \$525 million, with another \$75 million available under our accordion (subject to lenders' approval). We secured an initial interest rate of approximately 3.27%, which was equal to the one-month LIBOR rate plus the applicable margin based on the then-current total leverage ratio. No financial covenants were amended.
- The \$75 million term loan provides increased liquidity and preserves financial flexibility in consideration of the disruption and uncertainty resulting from the COVID-19 pandemic. Proceeds may be used in the future for working capital and other general corporate purposes as permitted by the credit agreement. Net liquidity available under our credit facility was \$294 million at June 27, 2020.
- On April 8, 2020, we announced additional efforts to preserve cash and manage expenses in response to the COVID-19 pandemic including, among other things, discontinuing share repurchases under our Board-approved share repurchase program, temporarily reducing capital expenditures and negotiating rent deferrals and abatements for stores closed due to COVID-19. We furloughed nearly 40% of our team members with another 30% working reduced hours. The majority of our team members returned to work as stores reopened and customer demand increased during the quarter. In response to changes in the business, we have restructured some teams, which resulted in less than 10% of positions being eliminated from across the country as we reallocated headcount to support the changing needs of our business. Our CEO will not receive any cash compensation for the balance of the year through a 50% deferral and exchanging all remaining salary for restricted stock units. In addition, our Board of Directors and most of our leadership team reduced their cash compensation in exchange for restricted stock units. All team members' cash compensation has been meaningfully reduced to-date through variable compensation programs and other actions. We are temporarily suspending the Company's 401(k) match and selected other benefit programs. We also reduced our sales and marketing expenses, and temporarily halting most discretionary projects.

Our primary sources of liquidity are cash flows provided by operating activities and cash available under our \$450 million revolving credit facility, supplemented by the \$75 million 364-day term loan we added on April 3, 2020. The cash generated from ongoing operations and cash available under our revolving credit facility are expected to be adequate to maintain operations, and fund anticipated expansion and strategic initiatives for the foreseeable future.

Changes in the cash and cash equivalents during the six months ended June 27, 2020 primarily consisted of \$87 million of cash provided by operating activities that were partially offset by \$22 million of cash used to purchase property and equipment, a \$26 million decrease in short-term borrowings and \$42 million of cash used to repurchase our common stock (based on settlement, \$39 million under our Board-approved share repurchase program and \$3 million in connection with the vesting of employee restricted stock grants).

The following table summarizes our cash flows (\$ in millions). Amounts may not add due to rounding differences:

	Six Months Ended	
	June 27, 2020	June 29, 2019
Total cash provided by (used in):		
Operating activities	\$ 87.0	\$ 70.3
Investing activities	(22.6)	(31.3)
Financing activities	(64.3)	(39.0)
Net increase in cash and cash equivalents	<u>\$ 0.1</u>	<u>\$ 0.1</u>

Cash provided by operating activities for the six months ended June 27, 2020 was \$87 million, compared with \$70 million for the six months ended June 27, 2019. Significant components of the year-over-year change in cash provided by operating activities included: (i) a \$3 million decrease in net income for the six months ended June 27, 2020, compared with the same period one year ago; (ii) a \$27 million fluctuation in accounts payable resulting from a reduction in business activities due to the pandemic; (iii) a \$16 million fluctuation in prepaid expenses and other assets with both periods impacted by the timing of rent payments and current-year changes in business activities due to the pandemic; (iv) a \$14 million fluctuation in customer prepayments due to the strong recovery in customer demand the last two months of the quarter that outperformed forecasts and suppliers' fulfillment, which had been curtailed to navigate the challenges of the COVID-19 pandemic; and (v) a \$12 million fluctuation in income taxes payable/receivable as our final 2019 estimated tax payment was deferred from April 15, 2020 to July 15, 2020 based on an Internal Revenue Service postponement action.

Net cash used in investing activities to purchase property and equipment was \$22 million for the six months ended June 27, 2020, compared with \$34 million for the same period one year ago. The year-over-year decrease was primarily due to actions taken to temporarily reduce capital spending based on the economic uncertainties associated with the pandemic.

Net cash used in financing activities was \$64 million for the six months ended June 27, 2020, compared with \$39 million net cash used in investing activities for the same period one year ago. During the six months ended June 27, 2020, we repurchased \$42 million of our stock (based on settlement dates, \$39 million under our Board-approved share repurchase program and \$3 million in connection with the vesting of employee restricted stock awards), compared with \$100 million during the same period one year ago. Short-term borrowings decreased by \$26 million during the current-year period due to a \$4 million decrease in borrowings under our credit facility to \$227 million and a decrease in book overdrafts which are included in the net change in short-term borrowings. Short-term borrowings increased by \$57 million during the prior-year period due to an \$82 million increase in borrowings under our credit facility to \$282 million, partially offset by a decrease in book overdrafts.

Under our Board-approved share repurchase program, we repurchased 0.8 million shares at a cost of \$38 million (based on trade dates, an average of \$49.42 per share) during the six months ended June 27, 2020. During the six months ended June 29, 2019, we repurchased 2.1 million shares at a cost of \$81 million (an average of \$39.02 per share). The remaining authorization under our Board-approved share repurchase program at June 27, 2020 was \$437 million. There is no expiration date governing the period over which we can repurchase shares. In light of the uncertainty surrounding the impact of COVID-19, we have suspended all share repurchases under our Board-approved share repurchase program.

As of June 27, 2020, we had \$227 million of borrowings under our credit facility, including the \$75 million 364-day term loan that we added on April 3, 2020. We also had \$4 million in outstanding letters of credit. Net liquidity available under our credit facility was \$294 million at June 27, 2020. The credit agreement provides the lenders with a collateral security interest in substantially all of our assets and those of our subsidiaries and requires us to comply with, among other things, a maximum leverage ratio (4.5x) and a minimum interest coverage ratio (3.0x). Our leverage ratio as defined in our credit agreement was 2.8x as of June 27, 2020. Under the terms of the credit agreement, we pay a variable rate of interest and a commitment fee based on our leverage ratio. The credit agreement is for general corporate purposes and to meet our seasonal working capital requirements. As of June 27, 2020, the weighted-average interest rate on borrowings under the credit facility was 3.0% and we were in compliance with all financial covenants.

We have an agreement with Synchrony Bank to offer qualified customers revolving credit arrangements to finance purchases from us (Synchrony Agreement). The Synchrony Agreement contains financial covenants consistent with our credit facility, including a maximum leverage ratio and a minimum interest coverage ratio consistent with our credit agreement. As of June 27, 2020, we were in compliance with all financial covenants.

Under the terms of the Synchrony Agreement, Synchrony 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.

As the accounts are owned by Synchrony Bank, at no time are the accounts purchased or acquired from us. We are not liable to Synchrony Bank for our customers' credit defaults.

Non-GAAP Data Reconciliations

Earnings before Interest, Taxes, Depreciation and Amortization (Adjusted EBITDA)

We define earnings before interest, taxes, depreciation and amortization (Adjusted EBITDA) as net income plus: income tax expense, interest expense, depreciation and amortization, stock-based compensation and asset impairments. Management believes Adjusted EBITDA is a useful indicator of our financial performance and our ability to generate cash from operating activities. Our definition of Adjusted EBITDA may not be comparable to similarly titled definitions used by other companies. The table below reconciles Adjusted EBITDA, which is a non-GAAP financial measure, to the comparable GAAP financial measure.

Our Adjusted EBITDA calculations are as follows (in thousands):

	Three Months Ended		Trailing-Twelve Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Net (loss) income	\$ (12,630)	\$ 4,280	\$ 78,657	\$ 74,945
Income tax (benefit) expense	(3,435)	(263)	22,141	18,682
Interest expense	4,022	3,229	12,131	9,769
Depreciation and amortization	15,253	15,328	60,951	61,675
Stock-based compensation	5,033	4,250	15,853	12,558
Asset impairments	246	1	294	151
Adjusted EBITDA	<u>\$ 8,489</u>	<u>\$ 26,825</u>	<u>\$ 190,027</u>	<u>\$ 177,780</u>

Free Cash Flow

Our "free cash flow" data is considered a non-GAAP financial measure and is not in accordance with, or preferable to, "net cash provided by operating activities," or GAAP financial data. However, we are providing this information as we believe it facilitates analysis for investors and financial analysts.

The following table summarizes our free cash flow calculations (in thousands):

	Six Months Ended		Trailing-Twelve Months Ended	
	June 27, 2020	June 29, 2019	June 27, 2020	June 29, 2019
Net cash provided by operating activities	\$ 87,001	\$ 70,347	\$ 205,814	\$ 172,756
Subtract: Purchases of property and equipment	21,695	33,896	47,038	58,070
Free cash flow	<u>\$ 65,306</u>	<u>\$ 36,451</u>	<u>\$ 158,776</u>	<u>\$ 114,686</u>

Non-GAAP Data Reconciliations (continued)

Return on Invested Capital (ROIC)

(dollars in thousands)

ROIC is a financial measure we use to determine how efficiently we deploy our capital. It quantifies the return we earn on our invested capital. Management believes ROIC is also a useful metric for investors and financial analysts. We compute ROIC as outlined below. Our definition and calculation of ROIC may not be comparable to similarly titled definitions and calculations used by other companies. The tables below reconcile net operating profit after taxes (NOPAT) and total invested capital, which are non-GAAP financial measures, to the comparable GAAP financial measures:

	Trailing-Twelve Months Ended	
	June 27, 2020	June 29, 2019
Net operating profit after taxes (NOPAT)		
Operating income	\$ 112,831	\$ 103,393
Add: Rent expense ⁽¹⁾	90,349	84,210
Add: Interest income	97	4
Less: Depreciation on capitalized operating leases ⁽²⁾	(23,331)	(21,310)
Less: Income taxes ⁽³⁾	(42,735)	(40,319)
NOPAT	\$ 137,211	\$ 125,978
Average invested capital		
Total deficit	\$ (163,018)	\$ (157,302)
Add: Long-term debt ⁽⁴⁾	227,944	282,308
Add: Capitalized operating lease obligations ⁽⁵⁾	722,792	673,680
Total invested capital at end of period	\$ 787,718	\$ 798,686
Average invested capital ⁽⁶⁾	\$ 797,862	\$ 750,375
Return on invested capital (ROIC) ⁽⁷⁾	17.2 %	16.8 %

⁽¹⁾ Rent expense is added back to operating income to show the impact of owning versus leasing the related assets.

⁽²⁾ Depreciation is based on the average of the last five fiscal quarters' ending capitalized operating lease obligations (see note 5) for the respective reporting periods with an assumed thirty-year useful life. This life assumption is based on our long-term participation in given markets though specific retail location lease commitments are generally 5 to 10 years at inception. This is subtracted from operating income to illustrate the impact of owning versus leasing the related assets.

⁽³⁾ Reflects annual effective income tax rates, before discrete adjustments, of 23.7% and 24.2% for 2020 and 2019, respectively.

⁽⁴⁾ Long-term debt includes existing finance lease liabilities.

⁽⁵⁾ A multiple of eight times annual rent expense is used as an estimate for capitalizing our operating lease obligations. The methodology utilized aligns with the methodology of a nationally recognized credit rating agency.

⁽⁶⁾ Average invested capital represents the average of the last five fiscal quarters' ending invested capital balances.

⁽⁷⁾ ROIC equals NOPAT divided by average invested capital.

Note - Our ROIC calculation and data are considered non-GAAP financial measures and are not in accordance with, or preferable to, GAAP financial data. However, we are providing this information as we believe it facilitates analysis of the Company's financial performance by investors and financial analysts.

GAAP - generally accepted accounting principles in the U.S.

Off-Balance-Sheet Arrangements and Contractual Obligations

As of June 27, 2020, we were not involved in any unconsolidated special purpose entity transactions. Other than our \$4 million in outstanding letters of credit, we do not have any off-balance-sheet financing.

There have been no material changes in our contractual obligations, other than the amendment to our credit agreement, since the end of fiscal 2019. See Note 5, *Credit Agreement*, of the Notes to our Condensed Consolidated Financial Statements for information regarding our credit agreement. See our Annual Report on Form 10-K for the fiscal year ended December 28, 2019 for additional information regarding our other contractual obligations.

Critical Accounting Policies

We discuss our critical accounting policies and estimates in *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our Annual Report on Form 10-K for the fiscal year ended December 28, 2019. There were no significant changes in our critical accounting policies since the end of fiscal 2019 other than adding goodwill and indefinite-lived intangible assets as a critical accounting policy.

Description	Judgments and Uncertainties	Effect if Actual Results Differ from Assumptions
Goodwill and Indefinite-Lived Intangible Assets		
Goodwill represents the excess of cost over the fair value of identifiable net assets of businesses acquired. Our indefinite-lived intangible assets include trade names/trademarks.	The determination of fair value involves uncertainties because it requires management to make assumptions and to apply judgment to estimate industry and economic factors and the profitability of future business strategies. Management's assumptions also include projected revenues, operating profit levels and discount rates, as well as consideration of any other factors that may indicate potential impairment.	In the fourth quarter of fiscal 2019, management completed its annual goodwill and other indefinite-lived intangible asset impairment tests and determined there was no impairment. We believe our assumptions and judgments used in estimating cash flows and determining fair value were reasonable. However, unexpected changes to such assumptions and judgments could affect our impairment analyses and future results of operations, including an impairment charge that could be material. There have been no significant changes for the six months ended June 27, 2020.
See Note 1, <i>Business and Summary of Significant Accounting Policies</i> , and Note 5, <i>Goodwill and Intangible Assets, Net</i> , to the Notes to Consolidated Financial Statements, included in Item 8, <i>Financial Statements and Supplementary Data</i> , of the 2019 Annual Report on Form 10-K, for a complete discussion of our goodwill and indefinite-lived intangible assets.		

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to changes in market-based short-term interest rates that will impact our net interest expense. If overall interest rates were one percentage point higher than current rates, our annual net income would decrease by \$1.7 million based on the \$227 million of borrowings under our credit facility at June 27, 2020. We do not manage the interest-rate volatility risk of borrowings under our credit facility through the use of derivative instruments.

ITEM 4. 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 officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Our management, with the participation of our principal executive officer and principal 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 quarterly 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 quarterly report.

Changes in Internal Control

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 27, 2020, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved from time to time in various legal proceedings arising in the ordinary course of our business, including primarily commercial, product liability, employment and intellectual property claims. In accordance with U.S. generally accepted accounting principles, we record a liability in our consolidated financial statements with respect to any of these matters when it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. If a material loss is reasonably possible but not known or probable, and may be reasonably estimated, the estimated loss or range of loss is disclosed. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible material losses either because we believe that we have valid defenses to claims asserted against us, the proceeding has not advanced to a stage of discovery that would enable us to establish an estimate, or the potential loss is not material. We currently do not expect the outcome of pending legal proceedings to have a material effect on our consolidated results of operations, financial position or cash flows. Litigation, however, is inherently unpredictable, and it is possible that the ultimate outcome of one or more claims asserted against us could adversely impact our consolidated results of operations, financial position or cash flows. We expense legal costs as incurred.

On March 27, 2018, Level Sleep, LLC (Level Sleep) filed a patent infringement lawsuit against Sleep Number in the Federal District Court for the Eastern District of Texas. In its Complaint, Level Sleep claims that Sleep Number infringed two patents owned by Level Sleep, U.S. Patent Nos. 6,807,698 and 7,036,172 (the Patents), by, among other things, making, using, offering for sale, or selling within the United States, and/or importing into the United States, beds with sleep surfaces having foam with multiple zones in the longitudinal direction. Level Sleep has asserted that five non-360® beds no longer sold and two current non-360 beds infringe the Patents. Level Sleep seeks damages in the form of a reasonable royalty. Sleep Number has asserted that the Patents are invalid and that our products do not infringe the Patents. On January 14, 2020, the Court granted summary judgment in favor of Sleep Number, finding that Sleep Number's products do not infringe the Patents. Level Sleep has filed an appeal of the Court's summary judgment order. We intend to continue vigorously defending this matter.

ITEM 1A. RISK FACTORS

In addition to the risks discussed below and other information set forth in this Quarterly Report on Form 10-Q, our business, financial condition and operating results are subject to a number of risks and uncertainties, including both those that are specific to our business and others that affect all businesses operating in a global environment. Investors should carefully consider the information in this report under the heading, *Management's Discussion and Analysis of Financial Condition and Results of Operations* and also the information under the heading, *Risk Factors* in our most recent Annual Report on Form 10-K. The risk factors discussed in the Annual Report on Form 10-K and in this Quarterly Report on Form 10-Q do not identify all risks that we face because our business operations could also be affected by additional risk factors that are not presently known to us or that we currently consider to be immaterial to our operations.

The COVID-19 pandemic has had, and is expected to continue to have, an adverse effect on our business and our financial results.

The COVID-19 pandemic has created significant volatility, uncertainty and economic disruption, which is adversely affecting our business operations and our financial results. Consumer concern about becoming ill with the virus and recommendations and/or mandates from federal, state and local authorities to close certain businesses, stay at home, practice social distancing or self-quarantine resulted in the temporary closure of the majority of our stores nationwide for a period of time between mid-March and mid-May. As of June 27, 2020, more than 95% of our stores were open, but as the COVID-19 pandemic continues, we may need to temporarily close some or all of our stores again. These actions have adversely affected our business, operations, demand for our product, traffic to our stores, and macroeconomic factors that affect us, such as consumer confidence and spending which have, in turn resulted in a loss of sales and profits. Even as certain restrictions begin to be eased or lifted, consumers may continue to take additional precautions that could cause a reduction in foot-traffic to certain of our locations or other changes in consumer spending behavior over time, and new restrictions may be implemented. With temporary closures to our retail store locations across the country and our delivery operations adversely impacted, we shifted to scale our digital capabilities including: remote retail selling, customer service, private appointments, flexible work schedules, solutions for contactless delivery, and remote access for team members across the country. This shift to our employees working remotely has amplified certain risks to our business, including increased demand on our information technology resources and systems and increased risk of cybersecurity breaches and IT outages. In addition, as recommendations and/or mandates have been eased or lifted across the country, we have implemented new health and safety policies at headquarters, stores, and our manufacturing and assembly locations as well as for our home delivery teams, which are intended to reduce the risk of contracting or spreading the coronavirus for employees, contractors, and customers who are unable to perform their roles or transact business remotely. The company has incurred additional costs and has diverted certain internal resources to develop and implement these new policies as well as provide, and in some cases manufacture, the personal protective equipment necessary to follow these new policies. The return to working in-person presents the risk that our new health and safety policies may not adequately protect our employees, contractors, and customers from contracting or spreading the coronavirus. We continue to monitor the effectiveness of our new policies to inform our future plans for welcoming all employees, even those who can work remotely, back to our facilities.

As the COVID-19 pandemic continues, we may further restrict the operations of our stores, delivery operations, and manufacturing and distribution facilities if we deem this necessary or if recommended or mandated by authorities and these measures could have a further material impact on our sales and profits.

In addition, we expect to continue to incur increased costs in our response to the pandemic, including, but not limited to, costs incurred to implement the operational changes described above and certain payments to or other costs relating to team members who are not working during the pandemic or whose jobs have been eliminated.

In response to the COVID-19 pandemic, including the significant reduction in customer visits to, and spending at, our stores caused by COVID-19, we have and continue to take actions to maintain liquidity including:

- discontinuing share repurchases under our Board-approved share repurchase program;
- reducing capital expenditures;
- negotiating rent deferrals and abatements for stores closed due to COVID-19;
- initially furloughing nearly 40% of our team members and reducing the working hours of another 30% of our team members;
- currently, the majority of our team members returned to work as stores reopened and customer demand increased during the quarter. In response to changes in the business, we have restructured some teams, which resulted in less than 10% of positions being eliminated from across the country as we reallocated headcount to support the changing needs of our business;
- CEO, board members and most of our leadership team deferred all or a portion of their cash compensation for the balance of the year in exchange for restricted stock units;
- meaningfully reducing all team members' compensation through variable compensation programs and other actions;
- temporarily suspending our 401(k) match and selected other employee benefit programs;
- reducing our sales and marketing expenses; and
- temporarily reducing discretionary projects across the company.

It is possible that our cost reduction efforts may be insufficient to maintain adequate liquidity. Also, if we do not respond appropriately to the pandemic, or if customers do not perceive our response to be adequate for a particular region or our company as a whole, we could suffer damage to our reputation and our brand, which could continue to adversely affect our business and financial results in the future.

We are highly dependent on the effectiveness of our marketing messages and the efficiency of our advertising expenditures in generating consumer awareness and sales of our products. In light of our reduced marketing expenses and adjustments to our marketing messages due to COVID-19, we may not be as successful in developing effective messages and achieving efficiency in our advertising expenditures.

Our business depends heavily on the uninterrupted operation of our two main manufacturing plants located in Irmo, South Carolina and Salt Lake City, Utah as well as our assembly distribution centers, two of which are co-located at the manufacturing plants and others located in Baltimore, Maryland and the greater Los Angeles, California area. Our business also depends on the successful operation of our bedding collection fulfillment center in Brooklyn Park, Minnesota and headquarters in Minneapolis, Minnesota. The operation of all of our facilities is critically dependent on our team members who staff these locations, and COVID-19 could directly threaten or impact their health and/or ability to work, and, therefore, adversely affect the operations of our facilities. In addition, COVID-19 and governmental mandates or recommendations in these jurisdictions could require closures of our facilities and otherwise limit or adversely impact our ability to continue these operations.

COVID-19 also impacted, and may continue to impact, our retail stores, home delivery operations, logistics, and domestic and foreign supply chain, including raw materials and components we source from third parties as well as our sole source of supply for adjustable foundations, particularly as a result of governmental mandates or recommendations. We expect that these impacts will continue through the third quarter of 2020, and may continue to impact our results in the remainder of 2020 and beyond.

Our temporary reduction of discretionary spending across the company and the inability or limitations of certain suppliers, both domestic and foreign, to operate due to governmental mandates or recommendations has delayed and may continue to delay the introduction of new product lines.

We have seen, and may continue to see, significant deterioration in macroeconomic factors that typically affect us, such as consumer confidence and spending.

The situation surrounding COVID-19 remains fluid and the potential for an adverse effect on our business and our financial results increases the longer the virus impacts activity levels in the United States and globally. For this reason, we cannot reasonably estimate with any degree of certainty the extent of the impact COVID-19 will have on our business. The extent and duration of the impact of COVID-19 on our business, operations, and financial results will depend on future developments, including the duration and spread of

the outbreak, governmental mandates and recommendations, business and workforce disruptions, and the related impact on consumer confidence and spending, all of which are highly uncertain and unpredictable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) – (b) Not applicable.

(c) Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased ⁽¹⁾⁽²⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs ⁽³⁾
March 29, 2020 through April 25, 2020	14,468	\$ 22.79	—	\$ 436,889,000
April 26, 2020 through May 23, 2020	—	\$ —	—	\$ 436,889,000
May 24, 2020 through June 27, 2020	—	\$ —	—	\$ 436,889,000
Total	14,468	\$ 22.79	—	\$ 436,889,000

⁽¹⁾ We did not repurchase any shares under our Board-approved \$500 million share repurchase program (effective September 29, 2019), during the three months ended June 27, 2020.

⁽²⁾ In connection with the vesting of employee restricted stock grants, we repurchased 14,468 shares of our common stock at a cost of \$0.3 million during the three months ended June 27, 2020.

⁽³⁾ There is no expiration date governing the period over which we can repurchase shares under our Board-approved share repurchase program. Any repurchased shares are constructively retired and returned to an unissued status. In light of the uncertainty surrounding the impact of COVID-19, we have suspended all share repurchases under our Board-approved share repurchase program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Exhibit Number	Description
10.1*	Form of Non-Statutory Stock Option Award Agreement (Non-Employee Director) under the Sleep Number Corporation 2020 Equity Incentive Plan
10.2*	Form of Restricted Stock Unit Award Agreement (Non-Employee Director) under the Sleep Number Corporation 2020 Equity Incentive Plan
10.3*	Form of Non-Statutory Stock Option Award Agreement (Employee) under the Sleep Number Corporation 2020 Incentive Plan
10.4*	Form of Performance Adjusted Restricted Stock Unit Award Agreement (ROIC),(Senior Team) under the Sleep Number Corporation 2020 Equity Incentive Plan
10.5*	Form of Restricted Stock Unit Award Agreement (3-Year Ratable Vest) under the Sleep Number Corporation 2020 Equity Incentive Plan
10.6*	Form of Restricted Stock Unity Award Agreement (3-Year Cliff Vest) under the Sleep Number Corporation 2020 Equity Incentive Plan
10.7	Sleep Number Corporation 2020 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 contained in Sleep Number's Current Report on Form 8-K filed May 13, 2020 (File No. 0-25121))
31.1*	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
32.2*	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
101.INS*	XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
104*	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)

* Filed Herewith

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SLEEP NUMBER CORPORATION

(Registrant)

Dated: July 24, 2020

By: /s/ Shelly R. Ibach
Shelly R. Ibach
Chief Executive Officer
(principal executive officer)

By: /s/ Robert J. Poirier
Robert J. Poirier
Chief Accounting Officer
(principal accounting officer)

FORM OF NON-STATUTORY STOCK OPTION AGREEMENT

THIS AGREEMENT is entered into and effective as of __, 20__ (the “Date of Grant”), by and between Sleep Number Corporation (the “Company”) and _ (the “Grantee”).

Unless defined in this Agreement, capitalized terms used in this Agreement shall have the meanings established in the Sleep Number Corporation 2020 Equity Incentive Plan (the “Plan”).

The Company has adopted the Plan, which authorizes the grant of Non-Statutory Stock Options to Non-Employee Directors. The Company desires to give the Grantee, a Non-Employee Director, a proprietary interest in the Company and its Subsidiaries in recognition of the Grantee’s contributions and as an added incentive to advance the interests of the Company and its Subsidiaries by granting to the Grantee Non-Statutory Stock Options pursuant to the Plan.

Accordingly, the parties agree as follows:

1. Terms of Grant of Options.

1.1 Type of Option. The Company hereby grants to the Grantee Non-Statutory Stock Options in the quantity and at the price listed below, subject to the vesting provisions and other terms and conditions of this Agreement (the “Options”).

1.2 Total Shares of Common Stock. The grant of Options gives the Grantee the right to purchase up to _____ shares of the Company’s common stock, par value \$0.01 per share (the “Common Stock”).

1.3 Exercise Price of Option. The exercise price of the Options is \$_____ per share.

1.4 Vesting Schedule. All Options granted under this Agreement will become exercisable, or “vest,” on the earlier of (i) the first anniversary of the Date of Grant or (ii) the next annual meeting of shareholders of the Company at which directors are elected (the “Vesting Period”), subject to the Grantee remaining in continuous service on the Board during the Vesting Period; provided, however, that such restrictions (the “Restrictions”) will lapse and terminate prior to the end of the Vesting Period as set forth in Section 2 below (or as otherwise set forth in the Plan for any circumstance not contemplated by the terms of Section 2).

1.5 Expiration of Options. The Grantee’s right to exercise the Options will terminate as to all unexercised Options at 5:00 p.m., Central Time, on __, 20__ (the “Expiration Date”), subject to earlier termination as described below or in the Plan.

1.6 Fractional Shares. The Grantee acknowledges that the Company will not issue or deliver fractional shares of Common Stock under this Agreement. All fractional shares will be rounded up to the nearest whole share.

2. Death, Disability, or other Termination of Service. The vesting and termination provisions of the Options granted hereby will be impacted by the termination of the Grantee’s

service on the Board, depending on the reason for termination of the Grantee's service on the Board, as set forth below.

2.1 Death or Disability. In the event that the Grantee's service on the Board is terminated prior to the end of the Vesting Period due to the Grantee's death or Disability, the Restrictions applicable to the Options will immediately lapse and terminate, and the Options will become immediately exercisable in full and will remain exercisable for up to three (3) years, but not beyond the Expiration Date.

2.2 Termination Due to Retirement or Resignation. In the event that the Grantee's service on the Board is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement or resignation from the Board and the Grantee has five (5) or more years of service on the Board prior to such retirement or resignation, then the Grantee will receive a pro rata portion of Options that vest, pursuant to this provision, based on the number of calendar days elapsed in the Vesting Period divided by the total number of calendar days in the Vesting Period (*e.g.*, if retirement or resignation occurs 243 calendar days into a 365-day Vesting Period, then 243/365ths of the Options will be vested). The remaining unvested Options will immediately terminate and be forfeited without notice of any kind. Upon any voluntary retirement or resignation from the Board, regardless of the number of years of service, Options that are vested will remain exercisable for up to three (3) years after retirement, but not beyond the Expiration Date.

2.3 Termination by the Company other than for Cause or Adverse Action. If the Grantee's service on the Board is terminated by the Company prior to the end of the Vesting Period (other than for Cause or Adverse Action), Options that have already vested pursuant to Section 1.4 as of the date of the Grantee's termination of service on the Board will remain exercisable for up to three (3) months, but not beyond the Expiration Date, after the Grantee's service on the Board ends. The Options that have not vested as of the date of the Grantee's termination of service on the Board will immediately terminate and be forfeited without notice of any kind.

2.4 Termination by the Company for Cause or Adverse Action. If the Grantee's service on the Board is terminated by the Company prior to the end of the Vesting Period for Cause or Adverse Action, all of the Grantee's rights under the Plan, this Agreement, and the Options granted hereby will immediately terminate and be forfeited without notice of any kind.

3. Notice. The Company is not required to give the Grantee notice of the termination of the Grantee's Options.

4. Exercise.

4.1 Manner of Exercise. An Option may be exercised by the Grantee in whole or in part from time to time, subject to the conditions contained in this Agreement and the Plan. The Options may be exercised 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 the Grantee), and by paying in full the total exercise price for the shares of Common Stock underlying the Options.

4.2 Payment of Exercise Price. The total purchase price of the shares of Common Stock to be purchased upon exercise of an Option will be paid in cash, including check, bank draft, or money order, unless otherwise determined by the Committee or as otherwise provided for in the Plan.

5. Rights of the Grantee.

5.1 Limitations on Transfer. Except pursuant to testamentary will or the laws of descent and distribution, or as otherwise permitted by the Plan, prior to the exercise or vesting of Options, Options issued under the Plan will not be assignable or transferable by the Grantee or subjected to any lien, during the lifetime of the Grantee, either voluntarily or involuntarily, directly or indirectly, by operation of law or otherwise. The Grantee may, however, designate a beneficiary, as provided for in the Plan.

5.2 Rights as a Shareholder. The Grantee will have no rights as a shareholder until the Grantee becomes the holder of record of shares of Common Stock issued upon the Grantee's exercise of the Options. As soon as reasonably possible after the satisfaction of any conditions to the effective issuance of shares of Common Stock in settlement of the Options, the shares will be issued by the Company.

5.3 Shares Purchased. Following the Grantee's exercise of the Grantee's rights to purchase shares of Common Stock under this Agreement, the shares of Common Stock purchased by the Grantee will be freely tradable, subject to the Company's policies and the Securities and Exchange Commission ("SEC") rules regarding insider trading. Members of the Board are required to comply with SEC Rule 144 and with the Company's policies with respect to insider trading in connection with any sale of shares received upon the exercise of any stock options.

5.4 Service. Nothing in this Agreement will interfere with or limit in any way the right of the Company to terminate the service of the Grantee at any time, nor confer upon the Grantee any right to continue in his or her service on the Board in any particular position or rate of pay or for any particular period of time.

6. Taxes.

6.1 Withholding Taxes. The Company is entitled to (i) withhold and deduct from future wages of the Grantee (or from other amounts that may be due and owing to the Grantee from the Company), or make other arrangements for the collection of all amounts the Company determines are legally required to satisfy any federal, state, or local withholding tax requirements attributable to the exercise of the Options, or (ii) require the Grantee promptly to remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, the Grantee agrees 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.

6.2 Income Tax Implications. There may be income tax consequences resulting from the exercise of the Options and/or sale of the shares of Common Stock received upon the exercise of the Options. The Grantee is urged to consult with his or her individual tax advisor regarding any tax consequences relating to these transactions. The Company accepts no responsibility for the income tax implications of the transactions resulting from this Agreement, except as set forth in Section 6.1.

7. Adjustments. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or divestiture (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), in order to prevent dilution or enlargement of the rights of the Grantee, will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) subject to this Agreement.

8. Subject to Plan. The Options granted pursuant to this Agreement have been granted under the Plan and, except as otherwise expressly provided in this Agreement, are subject to all of the terms and conditions of the Plan. In addition, the Grantee, by execution hereof, acknowledges having received a copy of the Plan and acknowledges that the Company, or a third party vendor designated by the Company, may deliver to the Grantee any documents related to the Grantee's participation in the Plan by electronic means, including through email, the Company's website, and through the website of the third party vendor designated by the Company. The provisions of this Agreement will be interpreted as to be consistent with the Plan, and any ambiguities in this Agreement will be interpreted by reference to the Plan. In the event that any provision of this Agreement is not authorized under the Plan, the terms of the Plan will prevail.

9. Nature of Grant. By accepting the Options, the Grantee acknowledges, understands, and agrees that:

9.1 The grant of Options under this Agreement is made voluntarily by the Company under the Plan, which is established by and subject to the discretion of the Committee, and the Grantee's participation in the Plan is voluntary.

9.2 The Options granted under this Agreement are not part of normal or expected compensation or salary for any purposes, including, but not limited to, calculating any severance, resignation, termination, redundancy, end of service payments, bonuses, long-service awards, pension, or retirement benefits or similar payments and in no event should be considered as compensation for, or relating in any way to, past services for the Company.

9.3 The future value of the Options or Common Stock underlying the Options is uncertain and cannot be predicted. If the underlying shares of Common Stock do not increase in value, the Option will have no value.

9.4 Other than provided in the Plan or in this Agreement, the Options granted to the Grantee do not create any claim or entitlement to compensation or damages arising from forfeiture of the Options.

10. Forfeiture, Clawback or Recoupment. The Options are subject to the forfeiture and clawback provisions pursuant to the Plan. Additionally, the Grantee may be subject to the Company's policy regarding clawback and forfeiture of certain compensation, as in effect at such time.

11. Miscellaneous.

11.1 Binding Effect. This Agreement will be binding upon the heirs, executors, administrators, and successors of the parties to this Agreement.

11.2 Governing Law. This Agreement and all rights and obligations under this Agreement will be construed in accordance with the Plan and governed by the laws of the State of Minnesota, without regard to conflicts of laws provisions. Any legal proceeding related to this Agreement will be brought in an appropriate Minnesota court, and the parties to this Agreement consent to the exclusive jurisdiction of the court for this purpose.

11.3 Entire Agreement. This Agreement and the Plan set forth the entire agreement and understanding of the parties to this Agreement with respect to the grant and vesting of the Options and the administration of the Plan and supersede all prior agreements, arrangements, plans, and understandings relating to the grant and vesting of the Options and the administration of the Plan.

11.4 Amendment and Waiver. Other than as provided in the Plan, this Agreement may be amended, waived, modified, or canceled only by a written instrument executed by the parties to this Agreement or, in the case of a waiver, by the party waiving compliance.

11.5 Code Section 409A. Payments of amounts under this Agreement are intended to be exempt from the requirements of Code section 409A, and this Agreement shall in all respects be administered and construed to give effect to such intent.

The parties hereto have executed this Agreement effective the day and year first above written.

SLEEP NUMBER CORPORATION

Shelly Ibach

Shelly Ibach
President and CEO

By execution of this Agreement, GRANTEE
the Grantee acknowledges having
received a copy of the Plan. ____ (Signature)

_____(Name and Address)

FORM OF RESTRICTED STOCK UNIT AWARD AGREEMENT

THIS AGREEMENT is entered into and effective as of _____, 20__ (the "Date of Grant"), by and between Sleep Number Corporation (the "Company") and _ (the "Grantee").

Unless defined in this Agreement, capitalized terms used in this Agreement shall have the meanings established in the Sleep Number Corporation 2020 Equity Incentive Plan (the "Plan").

The Company has adopted the Plan, which authorizes the grant of Restricted Stock Unit Awards to Non-Employee Directors. The Company desires to give the Grantee, a Non-Employee Director, a proprietary interest in the Company and its Subsidiaries in recognition of the Grantee's contributions and as an added incentive to advance the interests of the Company and its Subsidiaries by granting to the Grantee a Restricted Stock Unit Award pursuant to the Plan.

Accordingly, the parties agree as follows:

1. Grant of Award Units. The Company hereby grants to the Grantee a Restricted Stock Unit Award (the "Award") consisting of _ units (the "Award Units") that will be settled in shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), subject to the terms, conditions, and restrictions set forth below and in the Plan. Reference in this Agreement to the Award Units will be deemed to include the Dividend Proceeds (as defined in Section 3.3 of this Agreement) with respect to such Award Units that are retained and held by the Company as provided in Section 3.3 of this Agreement.

2. Grant Restriction.

2.1 Restriction and Forfeiture. The Grantee's right to the Award Units and the shares of Common Stock issuable under the Award Units will be fully vested at the end of the earlier of (i) the first anniversary of the Date of Grant or (ii) the next annual meeting of shareholders of the Company at which directors are elected (the "Vesting Period"), subject to the Grantee remaining in continuous service on the Board during the Vesting Period; provided, however, that such restrictions (the "Restrictions") will lapse and terminate prior to the end of the Vesting Period as set forth in Section 2.2 below (or as otherwise set forth in the Plan for any circumstance not contemplated by the terms of Section 2.2).

2.2 Death, Disability, or other Termination of Service.

(a) Death or Disability. In the event that the Grantee's service on the Board is terminated prior to the end of the Vesting Period due to the Grantee's death or Disability, the Restrictions applicable to the Award Units will immediately lapse and terminate, and the shares of Common Stock to be issued in settlement of the Award Units will be issued as soon as reasonably possible.

(b) Termination Due to Retirement or Resignation.

(i) In the event that the Grantee's service on the Board is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement or resignation from the Board and the Grantee has five (5) or more years of service

on the Board prior to such retirement or resignation, then the Grantee will receive a pro rata portion of Award Units that vest, pursuant to this provision, based on the number of calendar days elapsed in the Vesting Period divided by the total number of calendar days in the Vesting Period (e.g., if retirement or resignation occurs 243 calendar days into a 365-day Vesting Period, then 243/365ths of the Award Units will be vested). The shares of Common Stock to be issued in settlement of the vested Award Units will be issued as soon as reasonably possible. The remaining unvested Award Units will immediately terminate and be forfeited without notice of any kind.

(ii) In the event that the Grantee's service on the Board is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement or resignation from the Board and the Grantee has fewer than five (5) years of service on the Board prior to such retirement or resignation, all rights of the Grantee under this Agreement will immediately terminate and be forfeited without notice of any kind.

(c) Termination for Reasons other than Death, Disability, or Retirement. Except as otherwise expressly provided in the Plan, in the event the Grantee's service on the Board is terminated prior to the end of the Vesting Period for any reason other than death, Disability, retirement, or resignation from the Board as provided above, all rights of the Grantee under this Agreement relating to Award Units with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

3. Issuance of Shares.

3.1 Timing. Vested Award Units shall be converted to shares of Common Stock on a one-for-one basis, and such shares shall be issued as soon as reasonably possible after the end of the Vesting Period, subject to the provisions set forth above applicable to vesting events that occur prior to the end of the Vesting Period.

3.2 Limitations on Transfer. Award Units will not be assignable or transferable by the Grantee, either voluntarily or involuntarily, and may not be subjected to any lien, directly or indirectly, by operation of law or otherwise. Any attempt to transfer, assign, or encumber the Award Units, other than in accordance with this Agreement and the Plan, will be null and void and will void the Award, and all Award Units for which the Restrictions have not lapsed will be forfeited and immediately returned to the Company.

3.3 Dividends and Other Distributions. The Award Units are being granted with an equal number of dividend equivalents. Accordingly, the Grantee is entitled to receive an additional award unit with a value equal to any dividends or distributions (including, without limitation, any cash dividends, stock dividends or dividends in kind, the proceeds of any stock split, or the proceeds resulting from any changes or exchanges described in Section 6 of this Agreement, all of which are referred to herein collectively as the "Dividend Proceeds") that are paid or payable with respect to one share of Common Stock for each Award Unit, which will be subject to the same rights, restrictions, and performance conditions under this Agreement as the Award Units to which such dividends or distributions relate. The number of additional award

units to be received as dividend equivalents for each Award Unit shall be determined by dividing the cash dividend per share by the Fair Market Value of one share of Common Stock on the dividend or distribution payment date. All such additional award units received as dividend equivalents will be subject to the same restrictions and performance conditions as the Award Units to which such Dividend Proceeds relate.

3.4 Fractional Shares. The Grantee acknowledges that the Company will not issue or deliver fractional shares of Common Stock under this Agreement. All fractional shares will be rounded up to the nearest whole share.

4. Rights as a Shareholder. The Grantee will have no rights as a shareholder until the Grantee becomes the holder of record of shares of Common Stock issued in settlement of the Award Units. As soon as reasonably possible after the satisfaction of any conditions to the effective issuance of shares of Common Stock in settlement of the Award Units, the shares will be issued by the Company.

5. Withholding Taxes. The Company is entitled to (i) withhold and deduct from future wages of the Grantee (or from other amounts that may be due and owing to the Grantee from the Company), or to withhold from the shares of Common Stock that would otherwise be determined to be paid to the Company out of Dividend Proceeds, or make other arrangements for the collection of all amounts the Company determines are legally required to satisfy any federal, state, or local withholding tax requirements attributable to the receipt of the Award, the receipt of dividends or distributions on Award Units, or the lapse or termination of the Restrictions applicable to Award Units, or (ii) require the Grantee promptly to remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, the Grantee agrees 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.

6. Adjustments. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or divestiture (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), in order to prevent dilution or enlargement of the rights of the Grantee, will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) subject to this Award.

7. Subject to Plan. The Award and the Award Units granted pursuant to this Agreement have been granted under the Plan and, except as otherwise expressly provided in this Agreement, are subject to all of the terms and conditions of the Plan. In addition, the Grantee, by execution hereof, acknowledges having received a copy of the Plan and acknowledges that the Company, or a third party vendor designated by the Company, may deliver to the Grantee any documents related to the Grantee's participation in the Plan by electronic means, including through email, the Company's website, and through the website of the third party vendor designated by the Company. The provisions of this Agreement will be interpreted as to be consistent with the Plan, and any ambiguities in this Agreement will be interpreted by reference to the Plan. In the event that any provision of this Agreement is not authorized under the Plan, the terms of the Plan will prevail.

8. Forfeiture, Clawback or Recoupment. This Award is subject to the forfeiture and clawback provisions pursuant to the Plan. Additionally, the Grantee may be subject to the Company's policy regarding clawback and forfeiture of certain compensation, as in effect at such time.

9. Miscellaneous.

9.1 Binding Effect. This Agreement will be binding upon the heirs, executors, administrators, and successors of the parties to this Agreement.

9.2 Governing Law. This Agreement and all rights and obligations under this Agreement will be construed in accordance with the Plan and governed by the laws of the State of Minnesota, without regard to conflicts of laws provisions. Any legal proceeding related to this Agreement will be brought in an appropriate Minnesota court, and the parties to this Agreement consent to the exclusive jurisdiction of the court for this purpose.

9.3 Entire Agreement. This Agreement and the Plan set forth the entire agreement and understanding of the parties to this Agreement with respect to the grant and vesting of this Award and the administration of the Plan and supersede all prior agreements, arrangements, plans, and understandings relating to the grant and vesting of this Award and the administration of the Plan.

9.4 Amendment and Waiver. Other than as provided in the Plan, this Agreement may be amended, waived, modified, or canceled only by a written instrument executed by the parties to this Agreement or, in the case of a waiver, by the party waiving compliance.

9.5 Code Section 409A. Payments of amounts under this Agreement are intended to be exempt from the requirements of Code section 409A, and this Agreement shall in all respects be administered and construed to give effect to such intent.

The parties hereto have executed this Agreement effective the day and year first above written.

SLEEP NUMBER CORPORATION

Shelly Ibach

Shelly Ibach
President and CEO

By execution of this Agreement, GRANTEE
the Grantee acknowledges having
received a copy of the Plan. ____
(Signature)

(Name and Address)

FORM OF NON-STATUTORY STOCK OPTION AGREEMENT

THIS AGREEMENT is entered into and effective as of _____, 20__ (the "Date of Grant"), by and between Sleep Number Corporation (the "Company") and _ (the "Grantee").

Unless defined in this Agreement, capitalized terms used in this Agreement shall have the meanings established in the Sleep Number Corporation 2020 Equity Incentive Plan (the "Plan").

The Company has adopted the Plan, which authorizes the grant of Non-Statutory Stock Options to Employees. The Company desires to give the Grantee, an Employee, a proprietary interest in the Company and its Subsidiaries in recognition of the Grantee's contributions and as an added incentive to advance the interests of the Company and its Subsidiaries by granting to the Grantee Non-Statutory Stock Options pursuant to the Plan.

Accordingly, the parties agree as follows:

1. Terms of Grant of Options.

1.1 Type of Option. The Company hereby grants to the Grantee Non-Statutory Stock Options in the quantity and at the price listed below, subject to the vesting provisions and other terms and conditions of this Agreement (the "Options").

1.2 Total Shares of Common Stock. The grant of Options gives the Grantee the right to purchase up to _____ shares of the Company's common stock, par value \$0.01 per share (the "Common Stock").

1.3 Exercise Price of Option. The exercise price of the Options is \$_____ per share.

1.4 Vesting Schedule. The Options granted under this Agreement will become exercisable, or "vest," in installments of one-third (1/3) of the total number of Options on each of the first three (3) anniversaries of the Date of Grant (the "Vesting Period"), subject to the Grantee remaining in continuous employment or service with the Company through each of such vesting dates during the Vesting Period; provided, however, that such restrictions (the "Restrictions") will lapse and terminate prior to the end of the Vesting Period as set forth in Section 3 and Section 4 below (or as otherwise set forth in the Plan for any circumstance not contemplated by the terms of Section 3 and Section 4).

1.5 Expiration of Options. The Grantee's right to exercise the Options will terminate as to all unexercised Options at 5:00 p.m., Central Time, on _____, 20__ (the "Expiration Date"), subject to earlier termination as described below or in the Plan.

1.6 Fractional Shares. The Grantee acknowledges that the Company will not issue or deliver fractional shares of Common Stock under this Agreement. All fractional shares will be rounded up to the nearest whole share.

2. Non-Compete Agreement as Consideration. In consideration for the grant of Options contemplated by Section 1 of this Agreement, the Grantee agrees to execute and be bound by the terms of the Employee Inventions, Confidentiality, Non-Compete and Mutual Arbitration Agreement (the "Non-Compete Agreement") attached hereto. Failure to execute the Non-Compete Agreement will cause the Options to automatically terminate and be forfeited without any further action.

3. Death, Disability, or other Termination of Employment or Service. The vesting and termination provisions of the Options granted hereby will be impacted by the termination of the Grantee's employment, depending on the reason for termination of the Grantee's employment, as set forth below.

3.1 Death or Disability. In the event that the Grantee's employment or service is terminated prior to the end of the Vesting Period due to the Grantee's death or Disability, the Restrictions applicable to the Options will immediately lapse and terminate, and the Options will become immediately exercisable in full and will remain exercisable for up to two (2) years, but not beyond the Expiration Date.

3.2 Termination Due to Retirement.

(a) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement at or beyond age fifty-five (55) and the Grantee has five (5) or more years of service with the Company prior to such retirement, then the Grantee will have one (1) year, but not beyond the Expiration Date, to exercise the sum of (i) Options that had vested (if any) through the effective retirement date according to Section 1.4, plus (ii) a pro rata portion of Options that vest, pursuant to this provision, based on the number of calendar days elapsed since the most recent anniversary of the Date of Grant as of the date of retirement, divided by the total number of calendar days in the Vesting Period (collectively, the "Pro Rata Options"). The remaining unvested Options will immediately terminate and be forfeited without notice of any kind.

For example, if the Grantee was granted 1,200 Options and retirement occurs 548 calendar days into the Vesting Period, assuming the Vesting Period contains 1,095 calendar days, the Grantee would have (i) $1,200/3 = 400$ Options vested pursuant to Section 1.4, plus (ii) $1,200 \times (548/1,095) = 601$ Pro Rata Options.

(b) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement prior to age fifty-five (55) or the Grantee has fewer than five (5) years of service with the Company prior to retirement, all rights of the Grantee under the Plan and this Agreement relating to all Options with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

(c) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement at or beyond age sixty (60) and the Grantee has five

(5) or more years of service with the Company prior to retirement, the Grantee will become fully vested in, and have three (3) years, but not beyond the Expiration Date, to exercise all Options awarded pursuant to this Agreement if the following criteria are met: (i) the Grantee provides written notice of the Grantee's intention to retire one (1) year before the Grantee's actual retirement date, and (ii) the Grantee's actual retirement date is at least one (1) year after the Date of Grant.

3.3 Voluntary Termination other than upon Retirement. If the Grantee voluntarily terminates his or her employment or service with the Company prior to the end of the Vesting Period (other than as set forth in Section 3.2(a) or Section 3.2(c)), any Options that have vested pursuant to Section 1.4 as of the date of the Grantee's termination of employment or service will remain exercisable for up to three (3) months, but not beyond the Expiration Date, after the Grantee's employment or service ends. The Options that have not vested as of the date of the Grantee's termination of employment or service will immediately terminate and be forfeited without notice of any kind.

3.4 Termination by the Company other than for Cause or Adverse Action. If the Grantee's employment or service is terminated by the Company prior to the end of the Vesting Period (other than for Cause or Adverse Action), Options that have already vested pursuant to Section 1.4 as of the date of the Grantee's termination of employment or service will remain exercisable for up to three (3) months, but not beyond the Expiration Date, after the Grantee's employment or service ends. The Options that have not vested as of the date of the Grantee's termination of employment or service will immediately terminate and be forfeited without notice of any kind.

3.5 Termination by the Company for Cause or Adverse Action. If the Grantee's employment or service is terminated by the Company or a Subsidiary prior to the end of the Vesting Period for Cause or Adverse Action, all of the Grantee's rights under the Plan, this Agreement, and the Options granted hereby will immediately terminate and be forfeited without notice of any kind.

4. Forfeiture, Clawback, or Recoupment. The Options are subject to the forfeiture and clawback provisions pursuant to the Plan. Additionally, the Grantee may be subject to the Company's policy regarding clawback and forfeiture of certain compensation, as in effect at such time. In addition to the other rights set forth in the Plan belonging to the Committee, if it is determined by the Committee, acting in its sole discretion, that the Grantee has taken any action that would constitute Cause or Adverse Action or that is subject to any other or additional "clawback," forfeiture, or recoupment policy adopted by the Company, either prior to or after the date of this Agreement, or that the Grantee has violated the Non-Compete Agreement, as set forth in Section 2, (i) all of the Grantee's rights under the Plan and any agreements evidencing options granted under the Plan, including the Options evidenced by this Agreement, then held shall terminate upon the effectiveness of such Committee action without notice of any kind and will be forfeited; and (ii) the Committee, in its sole discretion, may require the Grantee to surrender and return, transfer, or assign to the Company all or any portion of the shares of Common Stock received, or to disgorge all or any profits or any other economic value (however defined by the Committee) made or realized by the Grantee or the Grantee's affiliate during the period beginning one (1) year prior to the Grantee's termination of employment or service with

the Company, in connection with any options granted under the Plan, including the Options, or any shares of Common Stock issued upon the exercise or vesting of any Non-Statutory Stock Options granted under the Plan, including the Options. This Section 4 shall not apply and shall automatically become void *ab initio* following a Change in Control.

5. Notice. The Company is not required to give the Grantee notice of the termination of the Grantee's Options.

6. Exercise.

6.1 Manner of Exercise. An Option may be exercised by the Grantee in whole or in part from time to time, subject to the conditions contained in this Agreement and the Plan. The Options may be exercised 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 the Grantee), and by paying in full the total exercise price for the shares of Common Stock underlying the Options.

6.2 Payment of Exercise Price. The total purchase price of the shares of Common Stock to be purchased upon exercise of an Option will be paid in cash, including check, bank draft, or money order, unless otherwise determined by the Committee or as otherwise provided for in the Plan.

7. Rights of the Grantee.

7.1 Limitations on Transfer. Except pursuant to testamentary will or the laws of descent and distribution, or as otherwise permitted by the Plan, prior to the exercise or vesting of Options, Options issued under the Plan will not be assignable or transferable by the Grantee or subjected to any lien, during the lifetime of the Grantee, either voluntarily or involuntarily, directly or indirectly, by operation of law or otherwise. The Grantee may, however, designate a beneficiary, as provided for in the Plan.

7.2 Rights as a Shareholder. The Grantee will have no rights as a shareholder until the Grantee becomes the holder of record of shares of Common Stock issued upon the Grantee's exercise of the Options. As soon as reasonably possible after the satisfaction of any conditions to the effective issuance of shares of Common Stock in settlement of the Options, the shares will be issued by the Company.

7.3 Shares Purchased. Following the Grantee's exercise of the Grantee's rights to purchase shares of Common Stock under this Agreement, the shares of Common Stock purchased by the Grantee will be freely tradable, subject to the Company's policies and the Securities and Exchange Commission ("SEC") rules regarding insider trading. Executive officers and members of the Board are required to comply with SEC Rule 144 and with the Company's policies with respect to insider trading in connection with any sale of shares received upon the exercise of any stock options.

7.4 Employment or Service. Nothing in this Agreement will interfere with or limit in any way the right of the Company or any Subsidiary to terminate the employment or service of

the Grantee at any time, nor confer upon the Grantee any right to continue in the employment or service with the Company or any Subsidiary at any particular position or rate of pay or for any particular period of time.

8. Taxes.

8.1 Withholding Taxes. The Company is entitled to (i) withhold and deduct from future wages of the Grantee (or from other amounts that may be due and owing to the Grantee from the Company), or make other arrangements for the collection of all amounts the Company determines are legally required to satisfy any federal, state, or local withholding and employment-related tax requirements attributable to the exercise of the Options, or (ii) require the Grantee promptly to remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, the Grantee agrees 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.

8.2 Income Tax Implications. There may be income tax consequences resulting from the exercise of the Options and/or sale of the shares of Common Stock received upon the exercise of the Options. The Grantee is urged to consult with his or her individual tax advisor regarding any tax consequences relating to these transactions. The Company accepts no responsibility for the income tax implications of the transactions resulting from this Agreement, except as set forth in Section 8.1.

9. Adjustments. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or divestiture (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), in order to prevent dilution or enlargement of the rights of the Grantee, will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) subject to this Agreement.

10. Subject to Plan. The Options granted pursuant to this Agreement have been granted under the Plan and, except as otherwise expressly provided in this Agreement, are subject to all of the terms and conditions of the Plan. In addition, the Grantee, by execution hereof, acknowledges having received a copy of the Plan and acknowledges that the Company, or a third party vendor designated by the Company, may deliver to the Grantee any documents related to the Grantee's participation in the Plan by electronic means, including through email, the Company's website, and through the website of the third party vendor designated by the Company. The provisions of this Agreement will be interpreted as to be consistent with the Plan, and any ambiguities in this Agreement will be interpreted by reference to the Plan. In the event that any provision of this Agreement is not authorized under the Plan, the terms of the Plan will prevail.

11. Nature of Grant. By accepting the Options, the Grantee acknowledges, understands, and agrees that:

11.1 The grant of Options under this Agreement is made voluntarily by the Company under the Plan, which is established by and subject to the discretion of the Committee, and the Grantee's participation in the Plan is voluntary.

11.2 The Options granted under this Agreement are not part of normal or expected compensation or salary for any purposes, including, but not limited to, calculating any severance, resignation, termination, redundancy, end of service payments, bonuses, long-service awards, pension, or retirement benefits or similar payments and in no event should be considered as compensation for, or relating in any way to, past services for the Company.

11.3 The future value of the Options or Common Stock underlying the Options is uncertain and cannot be predicted. If the underlying shares of Common Stock do not increase in value, the Option will have no value.

11.4 Other than provided in the Plan or in this Agreement, the Options granted to the Grantee do not create any claim or entitlement to compensation or damages arising from forfeiture of the Options.

12. Miscellaneous.

12.1 Binding Effect. This Agreement will be binding upon the heirs, executors, administrators, and successors of the parties to this Agreement.

12.2 Governing Law. This Agreement and all rights and obligations under this Agreement will be construed in accordance with the Plan and governed by the laws of the State of Minnesota, without regard to conflicts of laws provisions. Any legal proceeding related to this Agreement will be brought in an appropriate Minnesota court, and the parties to this Agreement consent to the exclusive jurisdiction of the court for this purpose.

12.3 Entire Agreement. This Agreement and the Plan set forth the entire agreement and understanding of the parties to this Agreement with respect to the grant and vesting of the Options and the administration of the Plan and supersede all prior agreements, arrangements, plans, and understandings relating to the grant and vesting of the Options and the administration of the Plan.

12.4 Amendment and Waiver. Other than as provided in the Plan, this Agreement may be amended, waived, modified, or canceled only by a written instrument executed by the parties to this Agreement or, in the case of a waiver, by the party waiving compliance.

12.5 Code Section 409A. Payments of amounts under this Agreement are intended to be exempt from the requirements of Code section 409A, and this Agreement shall in all respects be administered and construed to give effect to such intent.

The parties hereto have executed this Agreement effective the day and year first above written.

SLEEP NUMBER CORPORATION

Shelly Ibach

Shelly Ibach
President and CEO

By execution of this Agreement, GRANTEE
the Grantee acknowledges having
received a copy of the Plan. ____
(Signature)

(Name and Address)

**FORM OF PERFORMANCE ADJUSTED
RESTRICTED STOCK UNIT AWARD AGREEMENT**

THIS AGREEMENT is entered into and effective as of _____, 20__ (the “Date of Grant”), by and between Sleep Number Corporation (the “Company”) and _ (the “Grantee”).

Unless defined in this Agreement, capitalized terms used in this Agreement shall have the meanings established in the Sleep Number Corporation 2020 Equity Incentive Plan (the “Plan”).

The Company has adopted the Plan, which authorizes the grant of Restricted Stock Unit Awards to Employees, Non-Employee Directors, and Consultants. The Company desires to give the Grantee a proprietary interest in the Company and its Subsidiaries in recognition of the Grantee’s contributions and as an added incentive to advance the interests of the Company and its Subsidiaries by granting to the Grantee a Restricted Stock Unit Award pursuant to the Plan.

Accordingly, the parties agree as follows:

1. Grant of Award Units and Performance Adjustments.

1.1 Grant of Award Units. The Company hereby grants to the Grantee a Restricted Stock Unit Award (the “Award”) consisting of _____ units (the “Award Units”) that will be settled in shares of the Company’s common stock, par value \$0.01 per share (the “Common Stock”), subject to the terms, conditions, and restrictions set forth below and in the Plan. Reference in this Agreement to the Award Units or the Adjusted Award Units (as defined in Section 1.2 of this Agreement) will be deemed to include the Dividend Proceeds (as defined in Section 3.3 of this Agreement) with respect to such Award Units or Adjusted Award Units as provided in Section 3.3 of this Agreement.

1.2 Performance Adjustments. The number of Award Units granted hereunder is subject to adjustment based on the Company’s level of achievement versus annual Net Sales growth goals and annual NOP growth goals for the 20__, 20__, and 20__ fiscal years (the “Performance Period”). (For purposes of this Agreement, “NOP” will be defined as Net Operating Income). The Net Sales growth goals and NOP growth goals will be equally weighted.

The annual Net Sales growth goals, the annual NOP growth goals and the corresponding performance adjustment multiples are as follows:

	Annual Growth Goals Over the Performance Period (20__ thru 20__ fiscal years)		Payout – as Multiple of Award Units to Vest
	Net Sales (50%)	NOP (50%)	
Threshold	__%	__%	0.5X
Target	__%	__%	1.0X
Maximum	__%	__%	2.0X

The calculation of the “Adjusted Award Units” based on performance versus these growth goals will be determined as follows:

(a) The Company’s actual annual growth will be measured for each of the two (2) performance goals and for each of the three (3) fiscal years of the Performance Period;

(b) A payout multiple will be determined for each performance goal and for each fiscal year, based on interpolation between the performance goals in the foregoing table (performance relative to a performance goal that is below the threshold for a fiscal year will result in a payout multiple of zero (0) for that performance goal for that fiscal year); and

(c) The mean, or average, of the resulting six (6) payout multiples will be applied to the number of Award Units to determine the number of “Adjusted Award Units.”

For example, if the annual Net Sales growth rate in 20__ is __%, the multiple for that performance goal for that year will be 1.0X; and if the annual NOP growth rate in 20__ is __%, the multiple for that performance goal for that year will be 1.5X. Similar multiples will be determined for each performance goal and for each of the following fiscal years. The resulting six (6) payout multiples will then be averaged to determine the final payout multiple. This final payout multiple times the number of Award Units originally granted results in the number of Adjusted Award Units that would vest, subject to all of the other proration and vesting provisions set forth in this Agreement.

In order to reduce the potential impact of volatility in NOP results, the annual NOP percentage growth rate will not in any case be determined from a base NOP level that is less than 50% of the 20__ NOP level. For example, if 20__ NOP is less than 50% of the 20__ NOP level, then the annual NOP percentage growth rate for 20__ will be determined from a base of 50% of the 20__ NOP level, rather than from the actual 20__ NOP level.

The “Adjusted Award Units” will be subject to reduction for failure to generate Return on Invested Capital (“ROIC”) that exceeds Weighted Average Cost of Capital by at least __ basis points (“bps”), as outlined in the table below. The measurement will be based on an average of the basis points difference between annual ROIC and WACC for the three fiscal years 20__, 20__, and 20__.

ROIC Basis Points difference versus WACC (e.g., ROIC of 12% vs. WACC of 10% = +200 bps)	Reduction to Final Payout
__ bps or lower	-20% of target award
__ to __ bps	-15% of target award
__ to __ bps	-10% of target award
__ to __ bps	-5% of target award
__ bps or greater	No reduction

For the purpose of this calculation, ROIC shall be defined as detailed in the annual 10-K disclosure.

For the purpose of this calculation, WACC shall be defined as detailed in Attachment A.

The Company's actual performance relative to the performance goals set forth above and the calculation of the Adjusted Award Units shall be determined by the Management Development and Compensation Committee (the "Committee") of the Board of Directors following the conclusion of the Performance Period. The Committee's determination shall be final and conclusive for all purposes under this Agreement. The number of Award Units resulting after adjustment as described above will be referred to herein as the "Adjusted Award Units."

1.3 Restrictive Covenant Agreement. In consideration for the grant of this Award, the Grantee agrees to execute and be bound by the terms of the Employee Inventions, Confidentiality, Non-Compete and Mutual Arbitration Agreement (the "Non-Compete Agreement") attached hereto, and the Grantee acknowledges that the Grantee's failure to execute the Non-Compete Agreement will cause this Award to automatically terminate and be forfeited without any further action.

2. Grant Restriction.

2.1 Restriction and Forfeiture. The Grantee's right to the Award Units or the Adjusted Award Units and the shares of Common Stock issuable under the Award Units or Adjusted Award Units will be subject to the Grantee remaining in continuous employment or service with the Company or any Subsidiary for a period of three (3) years (the "Vesting Period") following the Date of Grant; provided, however, that such employment or service period restrictions (the "Restrictions") will lapse and terminate prior to end of the Vesting Period as set forth in Section 2.2 below (or as otherwise set forth in the Plan for any circumstance not contemplated by the terms of Section 2.2).

2.2 Death, Disability, or other Termination of Employment or Service.

(a) Death. In the event that the Grantee's employment or service is terminated prior to the end of the Vesting Period due to the Grantee's death, the Restrictions applicable to the Award Units or Adjusted Award Units will immediately lapse and terminate, and the shares of Common Stock to be issued in settlement of the Award Units will be issued within 90 days of the Grantee's death, with the performance adjustment determination related to any incomplete fiscal year(s) within the Performance Period deemed to be satisfied at the target level, with no reduction based on ROIC performance.

(b) Disability. In the event that the Grantee's employment or service is terminated prior to the end of the Vesting Period due to the Grantee's Disability, the Grantee will become fully vested in the Award Units pending completion of the Performance Period and final determination of the Adjusted Award Units. The shares of Common Stock to be issued in settlement of the Adjusted Award Units will be retained

and held by the Company pending the final determination of the Adjusted Award Units and will be issued within 90 days of the end of the Vesting Period.

(c) Termination Due to Retirement.

(i) In the event that the Grantee's employment or other service is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement at or beyond age fifty-five (55) and the Grantee has five (5) or more years of service with the Company prior to such retirement, the Grantee will become vested in a pro rata portion of Award Units based on the number of calendar days elapsed in the Vesting Period as of the date of retirement (*e.g.*, If the Grantee was granted 1,200 Award Units, and if retirement occurs 730 calendar days into the 1,095 calendar days vesting period, then the Grantee will become vested with respect to an aggregate of 800 Award Units and the remaining 400 Award Units will immediately terminate and be forfeited without notice of any kind) pending completion of the Performance Period and final determination of the Adjusted Award Units.

(ii) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement prior to age fifty-five (55) or the Grantee has fewer than five (5) years of service with the Company prior to retirement, all rights of the Grantee under the Plan and this Agreement relating to all Award Units with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

(iii) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement at or beyond age sixty (60) and the Grantee has five (5) or more years of service with the Company prior to retirement, the Grantee will become fully vested in the Award Units pending completion of the Performance Period and final determination of the Adjusted Award Units if the following criteria are met: a) Grantee provides written notice of Grantee's intention to retire one year before Grantee's actual retirement date, and b) Grantee's actual retirement date is at least one year after the Date of Grant.

(iv) The shares of Common Stock to be issued in settlement of the Adjusted Award Units pursuant to paragraphs (i) or (iii) above will be retained and held by the Company pending the final determination of the Adjusted Award Units and will be issued within 90 days of the end of the Vesting Period.

(d) Termination for Reasons other than Death, Disability, or Retirement. In the event the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period for any reason other than death, Disability, or retirement as provided above, or if the Grantee is in the employ or service of a Subsidiary and the Subsidiary ceases to be a Subsidiary of the Company (unless the Grantee continues in the employ or service of the Company or another Subsidiary), all rights of the Grantee under this Agreement relating to Award Units with

respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

3. Issuance of Shares.

3.1 Timing. Vested Award Units or Adjusted Award Units shall be converted to shares of Common Stock on a one-for-one basis, and such shares shall be issued as soon as reasonably possible, but not more than 90 days, after the end of the Vesting Period, subject to the provisions set forth above applicable to vesting events that occur prior to the end of the Vesting Period.

3.2 Limitations on Transfer. Award Units or Adjusted Award Units will not be assignable or transferable by the Grantee, either voluntarily or involuntarily, and may not be subjected to any lien, directly or indirectly, by operation of law or otherwise. Any attempt to transfer, assign, or encumber the Award Units or Adjusted Award Units, other than in accordance with this Agreement and the Plan, will be null and void and will void the Award, and all Award Units or Adjusted Award Units for which the Restrictions have not lapsed will be forfeited and immediately returned to the Company.

3.3 Dividends and Other Distributions. The Award Units are being granted with an equal number of dividend equivalents. Accordingly, the Grantee is entitled to receive an additional award unit with a value equal to any dividends or distributions (including, without limitation, any cash dividends, stock dividends or dividends in kind, the proceeds of any stock split, or the proceeds resulting from any changes or exchanges described in Section 6 of this Agreement, all of which are referred to herein collectively as the "Dividend Proceeds") that are paid or payable with respect to one share of Common Stock for each Award Unit, which will be subject to the same rights, restrictions, and performance adjustments under this Agreement as the Award Units to which such dividends or distributions relate. The number of additional award units to be received as dividend equivalents for each Award Unit shall be determined by dividing the cash dividend per share by the Fair Market Value of one share of Common Stock on the dividend or distribution payment date. All such additional award units received as dividend equivalents will be subject to the same restrictions and performance adjustments as the Award Units to which such Dividend Proceeds relate.

3.4 Fractional Shares. The Grantee acknowledges that the Company will not issue or deliver fractional shares of Common Stock under this Agreement. All fractional shares will be rounded up to the nearest whole share.

4. Rights of Grantee.

4.1 Employment or Service. Nothing in this Agreement will interfere with or limit in any way the right of the Company or any Subsidiary to terminate the employment or service of the Grantee at any time, nor confer upon the Grantee any right to continue in the employment or service with the Company or any Subsidiary at any particular position or rate of pay or for any particular period of time.

4.2 Rights as a Shareholder. The Grantee will have no rights as a shareholder until the Grantee becomes the holder of record of shares of Common Stock issued in settlement of the

Adjusted Award Units. As soon as reasonably possible after the satisfaction of any conditions to the effective issuance of shares of Common Stock in settlement of the Adjusted Award Units, the shares will be issued by the Company.

5. Withholding Taxes. The Company is entitled to (i) withhold and deduct from future wages of the Grantee (or from other amounts that may be due and owing to the Grantee from the Company), or to withhold from the shares of Common Stock that would otherwise be determined to be paid to the Company out of Dividend Proceeds, or make other arrangements for the collection of all amounts the Company determines are legally required to satisfy any federal, state, or local withholding and employment-related tax requirements attributable to the receipt of the Award, the receipt of dividends or distributions on Award Units or Adjusted Award Units, or the lapse or termination of the Restrictions applicable to Award Units or Adjusted Award Units, or (ii) require the Grantee promptly to remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, the Grantee agrees 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.

6. Adjustments. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or divestiture (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), in order to prevent dilution or enlargement of the rights of the Grantee, will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) subject to this Award.

7. Subject to Plan. The Award and the Award Units granted pursuant to this Agreement have been granted under the Plan and, except as otherwise expressly provided in this Agreement, are subject to all of the terms and conditions of the Plan. In addition, the Grantee, by execution hereof, acknowledges having received a copy of the Plan and acknowledges that the Company, or a third party vendor designated by the Company, may deliver to the Grantee any documents related to the Grantee's participation in the Plan by electronic means, including through email, the Company's website, and through the website of the third party vendor designated by the Company. The provisions of this Agreement will be interpreted as to be consistent with the Plan, and any ambiguities in this Agreement will be interpreted by reference to the Plan. In the event that any provision of this Agreement is not authorized under the Plan, the terms of the Plan will prevail.

8. Forfeiture, Clawback or Recoupment. This Award is subject to the forfeiture and clawback provisions pursuant to the Plan. Additionally, the Grantee may be subject to the Company's policy regarding clawback and forfeiture of certain compensation, as in effect at such time. In addition to the other rights of the Committee under the Plan, if Grantee is determined by the Committee, acting in its sole discretion, to have taken any action that would constitute Adverse Action or Cause or that is subject to any other or additional "clawback," forfeiture, or recoupment policy adopted by the Company, either prior to or after the date of this Agreement, or to have violated the Non-Compete Agreement, as defined in Section 1.3, (i) all of Grantee's rights under the Plan and any agreements evidencing an award granted under the Plan, including

this Agreement evidencing this Award, then held by Grantee shall terminate and be forfeited upon the effectiveness of such Committee action, and without notice of any kind, and (ii) the Committee, in its sole discretion may require Grantee to surrender and return, transfer, or assign to the Company all or any portion of the shares of Common Stock received, or to disgorge all or any profits or any other economic value (however defined by the Committee) made or realized by Grantee or Grantee's affiliate, during the period beginning one (1) year prior to your termination of employment or service with the Company, in connection with any awards granted under the Plan, including this Award, or any shares of Common Stock issued upon the exercise or vesting of any awards, including this Award. This Section 8 shall not apply and shall automatically become void *ab initio* following a Change of Control.

9. Miscellaneous.

9.1 Binding Effect. This Agreement will be binding upon the heirs, executors, administrators, and successors of the parties to this Agreement.

9.2 Governing Law. This Agreement and all rights and obligations under this Agreement will be construed in accordance with the Plan and governed by the laws of the State of Minnesota, without regard to conflicts of laws provisions. Any legal proceeding related to this Agreement will be brought in an appropriate Minnesota court, and the parties to this Agreement consent to the exclusive jurisdiction of the court for this purpose.

9.3 Entire Agreement. This Agreement and the Plan set forth the entire agreement and understanding of the parties to this Agreement with respect to the grant and vesting of this Award and the administration of the Plan and supersede all prior agreements, arrangements, plans, and understandings relating to the grant and vesting of this Award and the administration of the Plan.

9.4 Amendment and Waiver. Other than as provided in the Plan, this Agreement may be amended, waived, modified, or canceled only by a written instrument executed by the parties to this Agreement or, in the case of a waiver, by the party waiving compliance.

9.5 Code Section 409A. Payments of amounts under this Agreement are intended to comply with the requirements of Code section 409A, and this Agreement shall in all respects be administered and construed to give effect to such intent. The Committee, in its sole discretion, may accelerate or delay distribution of any shares in payment of amounts due under this Agreement if and to the extent allowed under Code section 409A.

The parties hereto have executed this Agreement effective the day and year first above written.

SLEEP NUMBER CORPORATION

Shelly Ibach

Shelly Ibach
President and CEO

By execution of this Agreement, GRANTEE
the Grantee acknowledges having
received a copy of the Plan. ____
(Signature)

(Name and Address)

ATTACHMENT A: Definition for the Company's Weighted Average Cost of Capital (WACC)

Formula:

$$WACC = \frac{D}{V}r_D(1 - T) + \frac{E}{V}r_E$$

- D = Market value of all debt
- E = Market value of all common stock
- $V = D + E$ = Market value of the entire firm

r_D = Cost of debt

- r_E = Cost of equity
- T = Marginal corporate tax rate

WACC is an approximation of the average rate of return a company expects to compensate all of its different investors. The WACC formula and key assumptions used in the Company's WACC calculation are outlined below:

- The market value of all debt reflects the capitalization of our operating leases as debt, plus any other outstanding debt. We calculate our capitalized operating lease obligations as part of our Return on Invested Capital (ROIC) calculation. The market value of all debt (including capitalized operating lease obligations) for each fiscal year within the Performance Period will equal the amounts included in our publicly reported ROIC calculations
- The market value of all common stock for each fiscal year within the Performance Period is calculated based on the 5-quarter average (the first day of the first quarter and the last day of each of the 4 quarters) of our common shares outstanding multiplied by the respective closing share price at the end of each quarter
- Cost of debt is the effective interest rate a company would pay for its debt. Our research indicates our debt would receive a rating of approximately BB (high-yield corporate debt). We base our cost of debt on the FINRA/Bloomberg Active U.S. High Yield Corporate Bond Index rates computed on a five-quarter average (the first day of the first quarter and the last day of each of the 4 quarters) for each fiscal year within the Performance Period as reported on Bloomberg.com
- Cost of equity
 - Risk-free rate is the theoretical rate of return of an investment with no risk of financial loss. In practice, a bond issued by a government with a negligible risk of default is used. We base our risk-free rate on the average daily 10-year U.S. treasury bill rate during each fiscal year within the Performance Period
 - Risk premium is the return in excess of the risk-free rate that an investment (as adjusted for risk) is expected to yield. We use the risk premium by industry/sector as annually reported by the Stern School of Business at New York University. For the purposes of this calculation, we use the average of the annual risk premium estimates for the Furniture/Home Furnishings and Retail (Special Lines) industry sectors for the period that most closely corresponds to each fiscal year within the Performance Period
- Marginal corporate tax rate is our effective tax rate before discrete adjustments for each fiscal year within the Performance Period

If any benchmark or index referenced above is unavailable at the time of the performance measurement, we will substitute with a substantially similar benchmark or index approved by the Compensation Committee

FORM OF RESTRICTED STOCK UNIT AWARD AGREEMENT

THIS AGREEMENT is entered into and effective as of __, 20__ (the "Date of Grant"), by and between Sleep Number Corporation (the "Company") and _ (the "Grantee").

Unless defined in this Agreement, capitalized terms used in this Agreement shall have the meanings established in the Sleep Number Corporation 2020 Equity Incentive Plan (the "Plan").

The Company has adopted the Plan, which authorizes the grant of Restricted Stock Unit Awards to Employees, Non-Employee Directors, and Consultants. The Company desires to give the Grantee a proprietary interest in the Company and its Subsidiaries in recognition of the Grantee's contributions and as an added incentive to advance the interests of the Company and its Subsidiaries by granting to the Grantee a Restricted Stock Unit Award pursuant to the Plan.

Accordingly, the parties agree as follows:

1. Grant of Award Units. The Company hereby grants to the Grantee a Restricted Stock Unit Award (the "Award") consisting of ___ units (the "Award Units") that will be settled in shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), subject to the terms, conditions, and restrictions set forth below and in the Plan. Reference in this Agreement to the Award Units will be deemed to include the Dividend Proceeds (as defined in Section 3.3 of this Agreement) with respect to such Award Units that are retained and held by the Company as provided in Section 3.3 of this Agreement.

2. Grant Restriction.

2.1 Restriction and Forfeiture. The Grantee's right to the Award Units and the shares of Common Stock issuable under the Award Units will vest in three (3) as nearly equal as possible installments (rounding down to the nearest whole share if necessary) on each of the first three (3) anniversaries of the Date of Grant (the "Vesting Period"), subject to the Grantee remaining in continuous employment or service with the Company or any Subsidiary during the Vesting Period; provided, however, that such employment or service period restrictions (the "Restrictions") will lapse and terminate prior to end of the Vesting Period as set forth in Section 2.2 below (or as otherwise set forth in the Plan for any circumstance not contemplated by the terms of Section 2.2).

2.2 Death, Disability, or other Termination of Employment or Service.

(a) Death or Disability. In the event that the Grantee's employment or service is terminated prior to the end of the Vesting Period due to the Grantee's death or Disability, the Restrictions applicable to the Award Units will immediately lapse and terminate, and the shares of Common Stock to be issued in settlement of the Award Units will be issued as soon as reasonably possible.

(b) Termination Due to Retirement.

(i) In the event that the Grantee's employment or other service is terminated prior to the end of the Vesting Period by reason of the Grantee's

retirement at or beyond age fifty-five (55) and the Grantee has five (5) or more years of service with the Company prior to such retirement, the Grantee will become vested in a pro rata portion of Award Units based on the number of calendar days elapsed since the most recent anniversary of the Date of Grant as of the date of retirement, divided by the total number of calendar days in the Vesting Period (collectively, the "Pro Rata Award Units"). The remaining unvested Award Units will immediately terminate and be forfeited without notice of any kind.

For example, if the Grantee was granted 1,200 Award Units and retirement occurs 548 calendar days into the Vesting Period, assuming the Vesting Period contains 1,095 calendar days, the Grantee would have (i) $1,200/3 = 400$ Award Units vested pursuant to Section 2.1, plus (ii) $1,200 \times (183/1095) = 201$ Pro Rata Award Units. The shares of Common Stock to be issued in settlement of the vested Award Units will be issued as soon as reasonably possible after the Grantee's retirement.

(ii) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement prior to age fifty-five (55) or the Grantee has fewer than five (5) years of service with the Company prior to retirement, all rights of the Grantee under the Plan and this Agreement relating to all Award Units with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

(d) Termination for Reasons other than Death, Disability, or Retirement. In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period for any reason other than death, Disability, or retirement as provided above, or if the Grantee is in the employ or service of a Subsidiary and the Subsidiary ceases to be a Subsidiary of the Company (unless the Grantee continues in the employ or service of the Company or another Subsidiary), all rights of the Grantee under this Agreement relating to Award Units with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

3. Issuance of Shares.

3.1 Timing. Vested Award Units shall be converted to shares of Common Stock on a one-for-one basis, and such shares shall be issued as soon as reasonably possible after the end of the Vesting Period, subject to the provisions set forth above applicable to vesting events that occur prior to the end of the Vesting Period.

3.2 Limitations on Transfer. Award Units will not be assignable or transferable by the Grantee, either voluntarily or involuntarily, and may not be subjected to any lien, directly or indirectly, by operation of law or otherwise. Any attempt to transfer, assign, or encumber the Award Units, other than in accordance with this Agreement and the Plan, will be null and void and will void the Award, and all Award Units for which the Restrictions have not lapsed will be forfeited and immediately returned to the Company.

3.3 Dividends and Other Distributions. The Award Units are being granted with an equal number of dividend equivalents. Accordingly, the Grantee is entitled to receive an additional award unit with a value equal to any dividends or distributions (including, without limitation, any cash dividends, stock dividends or dividends in kind, the proceeds of any stock split, or the proceeds resulting from any changes or exchanges described in Section 6 of this Agreement, all of which are referred to herein collectively as the “Dividend Proceeds”) that are paid or payable with respect to one share of Common Stock for each Award Unit, which will be subject to the same rights, restrictions, and performance conditions under this Agreement as the Award Units to which such dividends or distributions relate. The number of additional award units to be received as dividend equivalents for each Award Unit shall be determined by dividing the cash dividend per share by the Fair Market Value of one share of Common Stock on the dividend or distribution payment date. All such additional award units received as dividend equivalents will be subject to the same restrictions and performance conditions as the Award Units to which such Dividend Proceeds relate.

3.4 Fractional Shares. The Grantee acknowledges that the Company will not issue or deliver fractional shares of Common Stock under this Agreement. All fractional shares will be rounded up to the nearest whole share.

4. Rights of Grantee.

4.1 Employment or Service. Nothing in this Agreement will interfere with or limit in any way the right of the Company or any Subsidiary to terminate the employment or service of the Grantee at any time, nor confer upon the Grantee any right to continue in the employment or service with the Company or any Subsidiary at any particular position or rate of pay or for any particular period of time.

4.2 Rights as a Shareholder. The Grantee will have no rights as a shareholder until the Grantee becomes the holder of record of shares of Common Stock issued in settlement of the Award Units. As soon as reasonably possible after the satisfaction of any conditions to the effective issuance of shares of Common Stock in settlement of the Award Units, the shares will be issued by the Company.

5. Withholding Taxes. The Company is entitled to (i) withhold and deduct from future wages of the Grantee (or from other amounts that may be due and owing to the Grantee from the Company), or to withhold from the shares of Common Stock that would otherwise be determined to be paid to the Company out of Dividend Proceeds, or make other arrangements for the collection of all amounts the Company determines are legally required to satisfy any federal, state, or local withholding and employment-related tax requirements attributable to the receipt of the Award, the receipt of dividends or distributions on Award Units, or the lapse or termination of the Restrictions applicable to Award Units, or (ii) require the Grantee promptly to remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, the Grantee agrees 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.

6. Adjustments. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or

divestiture (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), in order to prevent dilution or enlargement of the rights of the Grantee, will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) subject to this Award.

7. Subject to Plan. The Award and the Award Units granted pursuant to this Agreement have been granted under the Plan and, except as otherwise expressly provided in this Agreement, are subject to all of the terms and conditions of the Plan. In addition, the Grantee, by execution hereof, acknowledges having received a copy of the Plan and acknowledges that the Company, or a third party vendor designated by the Company, may deliver to the Grantee any documents related to the Grantee's participation in the Plan by electronic means, including through email, the Company's website, and through the website of the third party vendor designated by the Company. The provisions of this Agreement will be interpreted as to be consistent with the Plan, and any ambiguities in this Agreement will be interpreted by reference to the Plan. In the event that any provision of this Agreement is not authorized under the Plan, the terms of the Plan will prevail.

8. Forfeiture, Clawback or Recoupment. This Award is subject to the forfeiture and clawback provisions pursuant to the Plan. Additionally, the Grantee may be subject to the Company's policy regarding clawback and forfeiture of certain compensation, as in effect at such time.

9. Miscellaneous.

9.1 Binding Effect. This Agreement will be binding upon the heirs, executors, administrators, and successors of the parties to this Agreement.

9.2 Governing Law. This Agreement and all rights and obligations under this Agreement will be construed in accordance with the Plan and governed by the laws of the State of Minnesota, without regard to conflicts of laws provisions. Any legal proceeding related to this Agreement will be brought in an appropriate Minnesota court, and the parties to this Agreement consent to the exclusive jurisdiction of the court for this purpose.

9.3 Entire Agreement. This Agreement and the Plan set forth the entire agreement and understanding of the parties to this Agreement with respect to the grant and vesting of this Award and the administration of the Plan and supersede all prior agreements, arrangements, plans, and understandings relating to the grant and vesting of this Award and the administration of the Plan.

9.4 Amendment and Waiver. Other than as provided in the Plan, this Agreement may be amended, waived, modified, or canceled only by a written instrument executed by the parties to this Agreement or, in the case of a waiver, by the party waiving compliance.

9.5 Code Section 409A. Payments of amounts under this Agreement are intended to be exempt from the requirements of Code section 409A, and this Agreement shall in all respects

be administered and construed to give effect to such intent.

The parties hereto have executed this Agreement effective the day and year first above written.

SLEEP NUMBER CORPORATION



Shelly Ibach
President and CEO

By execution of this Agreement, GRANTEE
the Grantee acknowledges having
received a copy of the Plan. ____
(Signature)

(Name and Address)

FORM OF RESTRICTED STOCK UNIT AWARD AGREEMENT

THIS AGREEMENT is entered into and effective as of __, 20__ (the "Date of Grant"), by and between Sleep Number Corporation (the "Company") and _ (the "Grantee").

Unless defined in this Agreement, capitalized terms used in this Agreement shall have the meanings established in the Sleep Number Corporation 2020 Equity Incentive Plan (the "Plan").

The Company has adopted the Plan, which authorizes the grant of Restricted Stock Unit Awards to Employees, Non-Employee Directors, and Consultants. The Company desires to give the Grantee a proprietary interest in the Company and its Subsidiaries in recognition of the Grantee's contributions and as an added incentive to advance the interests of the Company and its Subsidiaries by granting to the Grantee a Restricted Stock Unit Award pursuant to the Plan.

Accordingly, the parties agree as follows:

1. Grant of Award Units. The Company hereby grants to the Grantee a Restricted Stock Unit Award (the "Award") consisting of ___ units (the "Award Units") that will be settled in shares of the Company's common stock, par value \$0.01 per share (the "Common Stock"), subject to the terms, conditions, and restrictions set forth below and in the Plan. Reference in this Agreement to the Award Units will be deemed to include the Dividend Proceeds (as defined in Section 3.3 of this Agreement) with respect to such Award Units that are retained and held by the Company as provided in Section 3.3 of this Agreement.

2. Grant Restriction.

2.1 Restriction and Forfeiture. The Grantee's right to the Award Units and the shares of Common Stock issuable under the Award Units will be fully vested at the end of three (3) years from the Date of Grant (the "Vesting Period"), subject to the Grantee remaining in continuous employment or service with the Company or any Subsidiary during the Vesting Period; provided, however, that such employment or service period restrictions (the "Restrictions") will lapse and terminate prior to end of the Vesting Period as set forth in Section 2.2 below (or as otherwise set forth in the Plan for any circumstance not contemplated by the terms of Section 2.2).

2.2 Death, Disability, or other Termination of Employment or Service.

(a) Death or Disability. In the event that the Grantee's employment or service is terminated prior to the end of the Vesting Period due to the Grantee's death or Disability, the Restrictions applicable to the Award Units will immediately lapse and terminate, and the shares of Common Stock to be issued in settlement of the Award Units will be issued as soon as reasonably possible.

(b) Termination Due to Retirement.

(i) In the event that the Grantee's employment or other service is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement at or beyond age fifty-five (55) and the Grantee has five (5) or more

years of service with the Company prior to such retirement, the Grantee will become vested in a pro rata portion of Award Units based on the number of calendar days elapsed since the most recent anniversary of the Date of Grant as of the date of retirement, divided by the total number of calendar days in the Vesting Period (collectively, the "Pro Rata Award Units"). The remaining unvested Award Units will immediately terminate and be forfeited without notice of any kind.

For example, if the Grantee was granted 1,200 Award Units and retirement occurs 548 calendar days into the Vesting Period, assuming the Vesting Period contains 1,095 calendar days, the Grantee would have (i) $1,200/3 = 400$ Award Units vested pursuant to Section 2.1, plus (ii) $1,200 \times (183/1095) = 201$ Pro Rata Award Units. The shares of Common Stock to be issued in settlement of the vested Award Units will be issued as soon as reasonably possible after the Grantee's retirement.

(ii) In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period by reason of the Grantee's retirement prior to age fifty-five (55) or the Grantee has fewer than five (5) years of service with the Company prior to retirement, all rights of the Grantee under the Plan and this Agreement relating to all Award Units with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

(c) Termination for Reasons other than Death, Disability, or Retirement. In the event that the Grantee's employment or other service with the Company and all Subsidiaries is terminated prior to the end of the Vesting Period for any reason other than death, Disability, or retirement as provided above, or if the Grantee is in the employ or service of a Subsidiary and the Subsidiary ceases to be a Subsidiary of the Company (unless the Grantee continues in the employ or service of the Company or another Subsidiary), all rights of the Grantee under this Agreement relating to Award Units with respect to which the Restrictions have not lapsed will immediately terminate and be forfeited without notice of any kind.

3. Issuance of Shares.

3.1 Timing. Vested Award Units shall be converted to shares of Common Stock on a one-for-one basis, and such shares shall be issued as soon as reasonably possible after the end of the Vesting Period, subject to the provisions set forth above applicable to vesting events that occur prior to the end of the Vesting Period.

3.2 Limitations on Transfer. Award Units will not be assignable or transferable by the Grantee, either voluntarily or involuntarily, and may not be subjected to any lien, directly or indirectly, by operation of law or otherwise. Any attempt to transfer, assign, or encumber the Award Units, other than in accordance with this Agreement and the Plan, will be null and void and will void the Award, and all Award Units for which the Restrictions have not lapsed will be forfeited and immediately returned to the Company.

3.3 Dividends and Other Distributions. The Award Units are being granted with an equal number of dividend equivalents. Accordingly, the Grantee is entitled to receive an additional award unit with a value equal to any dividends or distributions (including, without limitation, any cash dividends, stock dividends or dividends in kind, the proceeds of any stock split, or the proceeds resulting from any changes or exchanges described in Section 6 of this Agreement, all of which are referred to herein collectively as the “Dividend Proceeds”) that are paid or payable with respect to one share of Common Stock for each Award Unit, which will be subject to the same rights, restrictions, and performance conditions under this Agreement as the Award Units to which such dividends or distributions relate. The number of additional award units to be received as dividend equivalents for each Award Unit shall be determined by dividing the cash dividend per share by the Fair Market Value of one share of Common Stock on the dividend or distribution payment date. All such additional award units received as dividend equivalents will be subject to the same restrictions and performance conditions as the Award Units to which such Dividend Proceeds relate.

3.4 Fractional Shares. The Grantee acknowledges that the Company will not issue or deliver fractional shares of Common Stock under this Agreement. All fractional shares will be rounded up to the nearest whole share.

4. Rights of Grantee.

4.1 Employment or Service. Nothing in this Agreement will interfere with or limit in any way the right of the Company or any Subsidiary to terminate the employment or service of the Grantee at any time, nor confer upon the Grantee any right to continue in the employment or service with the Company or any Subsidiary at any particular position or rate of pay or for any particular period of time.

4.2 Rights as a Shareholder. The Grantee will have no rights as a shareholder until the Grantee becomes the holder of record of shares of Common Stock issued in settlement of the Award Units. As soon as reasonably possible after the satisfaction of any conditions to the effective issuance of shares of Common Stock in settlement of the Award Units, the shares will be issued by the Company.

5. Withholding Taxes. The Company is entitled to (i) withhold and deduct from future wages of the Grantee (or from other amounts that may be due and owing to the Grantee from the Company), or to withhold from the shares of Common Stock that would otherwise be determined to be paid to the Company out of Dividend Proceeds, or make other arrangements for the collection of all amounts the Company determines are legally required to satisfy any federal, state, or local withholding and employment-related tax requirements attributable to the receipt of the Award, the receipt of dividends or distributions on Award Units, or the lapse or termination of the Restrictions applicable to Award Units, or (ii) require the Grantee promptly to remit the amount of such withholding to the Company. In the event that the Company is unable to withhold such amounts, for whatever reason, the Grantee agrees 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.

6. Adjustments. In the event of any reorganization, merger, consolidation, recapitalization, liquidation, reclassification, stock dividend, stock split, combination of shares, rights offering, or

divestiture (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), in order to prevent dilution or enlargement of the rights of the Grantee, will make appropriate adjustment (which determination will be conclusive) as to the number and kind of securities or other property (including cash) subject to this Award.

7. Subject to Plan. The Award and the Award Units granted pursuant to this Agreement have been granted under the Plan and, except as otherwise expressly provided in this Agreement, are subject to all of the terms and conditions of the Plan. In addition, the Grantee, by execution hereof, acknowledges having received a copy of the Plan and acknowledges that the Company, or a third party vendor designated by the Company, may deliver to the Grantee any documents related to the Grantee's participation in the Plan by electronic means, including through email, the Company's website, and through the website of the third party vendor designated by the Company. The provisions of this Agreement will be interpreted as to be consistent with the Plan, and any ambiguities in this Agreement will be interpreted by reference to the Plan. In the event that any provision of this Agreement is not authorized under the Plan, the terms of the Plan will prevail.

8. Forfeiture, Clawback or Recoupment. This Award is subject to the forfeiture and clawback provisions pursuant to the Plan. Additionally, the Grantee may be subject to the Company's policy regarding clawback and forfeiture of certain compensation, as in effect at such time.

9. Miscellaneous.

9.1 Binding Effect. This Agreement will be binding upon the heirs, executors, administrators, and successors of the parties to this Agreement.

9.2 Governing Law. This Agreement and all rights and obligations under this Agreement will be construed in accordance with the Plan and governed by the laws of the State of Minnesota, without regard to conflicts of laws provisions. Any legal proceeding related to this Agreement will be brought in an appropriate Minnesota court, and the parties to this Agreement consent to the exclusive jurisdiction of the court for this purpose.

9.3 Entire Agreement. This Agreement and the Plan set forth the entire agreement and understanding of the parties to this Agreement with respect to the grant and vesting of this Award and the administration of the Plan and supersede all prior agreements, arrangements, plans, and understandings relating to the grant and vesting of this Award and the administration of the Plan.

9.4 Amendment and Waiver. Other than as provided in the Plan, this Agreement may be amended, waived, modified, or canceled only by a written instrument executed by the parties to this Agreement or, in the case of a waiver, by the party waiving compliance.

9.5 Code Section 409A. Payments of amounts under this Agreement are intended to be exempt from the requirements of Code section 409A, except for a Grantee who becomes eligible for partial vesting following eligibility for retirement under Section 2(c), in which case

payment of amounts under the Agreement are intended, and this Agreement shall in all respects be administered and construed to give effect to such intent. A payment on account of a termination of employment by reason of the Grantee's retirement under Section 2(c) shall only be made if such termination is a "separation from service" under Code section 409A, and if payment is made as a result of such "separation from service" at such time the Grantee is a "specified employee" within the meaning of Code section 409A, then no shares shall be issued prior to the first business day after the earlier of (i) the date that is six months after the Grantee's separation from service, or (ii) the date of the Grantee's death.

The parties hereto have executed this Agreement effective the day and year first above written.

SLEEP NUMBER CORPORATION



Shelly Ibach
President and CEO

By execution of this Agreement, GRANTEE
the Grantee acknowledges having
received a copy of the Plan. ____

(Signature)

_____(Name and Address)

Certification by Chief Executive Officer

I, Shelly R. Ibach, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sleep Number 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: July 24, 2020

/s/ Shelly R. Ibach

Shelly R. Ibach

Chief Executive Officer

Certification by Chief Financial Officer

I, David R. Callen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sleep Number 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: July 24, 2020

/s/ David R. Callen

David R. Callen

Senior Vice President and Chief Financial Officer

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 Quarterly Report of Sleep Number Corporation (the "Company") on Form 10-Q for the quarter ended June 27, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Shelly R. Ibach, 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 her 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: July 24, 2020

/s/ Shelly R. Ibach

Shelly R. Ibach

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.

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 Quarterly Report of Sleep Number Corporation (the "Company") on Form 10-Q for the quarter ended June 27, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, David R. Callen, 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: July 24, 2020

/s/ David R. Callen

David R. Callen

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.