

Tempur Sealy International Inc.

Expect >20% upside to Street EPS on Mattress Firm acquisition closure

Reiterate Rating: BUY | PO: 57.50 USD | Price: 50.97 USD

Shares could re-rate higher as acquisition nears closing

In this note, we take a detailed look at what Tempur Sealy (TPX) could look like following its proposed acquisition of Mattress Firm. Assuming the deal closes at the end of 2024, we expect the combined entity to generate \$3.72/4.30 of EPS in 2025/2026 which is 22/26% above Street estimates. If TPX were to remain at its current \$50 share price following the close of the acquisition, the stock would trade at 13.4x forward 12M P/E (vs. 18.1x today) and 9.6x EV/EBITDA (vs. 11.5x today). Our current estimates don't include Mattress Firm, but to reflect potential upside from a successful acquisition closure, we're raising our PO to \$57.50 based on 19x '24E P/E (16x prior).

TPX assessing steps to clear anti-trust concerns

TPX announced its intent to acquire Mattress Firm in May 2023 with an expected close in 2H24. In Nov 2023, TPX announced that it had complied with the FTC's second request for documents and that it still expected a closure in 2H24. In Dec 2023, Furniture Today reported that TPX was looking to sell roughly 200 stores including a mix of Sleep Outfitters (owned by TPX) and Mattress Firm stores. We're encouraged that TPX is proactively considering divestitures as it indicates a path to clear anti-trust concerns. According to TPX, Mattress Firm has just 8% share of the North America retail bedding market which implies TPX's direct-to-customer business has just 1% share.

Leverage to remain manageable even at deal closure

Assuming the deal closes at the end of 2024, we estimate the combined entity will generate \$9.029bn of revenue in 2025 (after eliminating the roughly 15.5% of TPX's revenue that comes from Mattress Firm currently). We estimate the combined entity to generate \$1.590bn of EBITDA in 2025 (17.6% margin vs. our 17.9%E for TPX in 2023). We assume a transaction value of \$4.410bn (\$2.7bn cash + \$1.7bn equity assuming 34.2mn shares at a \$50 share price). We model TPX taking on \$2.4bn of new debt which would put its net leverage post-close at the low-end of its 3.0-3.25x target. We model net leverage declining to 2.5x by the end of 2025 (in-line with its 2.0-3.0x target).

Reiterate Buy on share gains, industry stabilization

We reiterate our Buy rating on TPX as we remain very confident in TPX's ability to continue to take share with potential upside from a stabilization in mattress industry demand and an added benefit from a successful Mattress Firm acquisition closure.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	3.19	2.60	2.40	3.02	3.43
EPS Change (YoY)	67.0%	-18.5%	-7.7%	25.8%	13.6%
Consensus EPS (Bloomberg)			2.41	2.76	3.05
DPS	0.31	0.39	0.44	0.47	0.51
Valuation (Dec)					
P/E	16.0x	19.6x	21.2x	16.9x	14.9x
Dividend Yield	0.6%	0.8%	0.9%	0.9%	1.0%
EV / EBITDA*	10.8x	13.3x	13.4x	11.9x	11.1x
Free Cash Flow Yield*	6.8%	0.8%	5.0%	6.4%	6.9%

* For full definitions of *IQmethod*SM measures, see page 5.

03 January 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	48.00	57.50
2024E EPS	3.00	3.02
2025E EPS	3.40	3.43

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Stock Data

Price	50.97 USD
Price Objective	57.50 USD
Date Established	3-Jan-2024
Investment Opinion	B-1-7
52-Week Range	33.50 USD - 51.68 USD
Mkt Val (mn) / Shares Out (mn)	8,781 USD / 172.3
Free Float	96.9%
Average Daily Value (mn)	87.38 USD
BofA Ticker / Exchange	TPX / NYS
Bloomberg / Reuters	TPX US / TPX.N
ROE (2023E)	283.8%
Net Dbt to Eqty (Dec-2022A)	NA
ESGMeter™	Medium

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Timestamp: 03 January 2024 05:00AM EST

iQprofileSM Tempur Sealy International Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	24.5%	16.2%	15.2%	17.2%	17.7%
Return on Equity	161.1%	331.0%	283.8%	135.9%	104.6%
Operating Margin	18.6%	14.5%	14.2%	15.7%	16.2%
Free Cash Flow	600	72	440	558	609

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	1.1x	0.8x	1.5x	1.4x	1.3x
Asset Replacement Ratio	1.1x	2.4x	1.5x	1.1x	1.1x
Tax Rate	24.1%	22.7%	24.7%	24.7%	24.7%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	408.7%
Interest Cover	15.0x	6.9x	5.4x	7.0x	7.5x

Income Statement Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Sales	4,931	4,921	4,943	5,132	5,370
% Change	34.1%	-0.2%	0.4%	3.8%	4.6%
Gross Profit	2,159	2,067	2,168	2,331	2,457
% Change	31.3%	-4.3%	4.9%	7.5%	5.4%
EBITDA	1,096	892	884	996	1,068
% Change	33.6%	-18.6%	-0.9%	12.7%	7.3%
Net Interest & Other Income	(62)	(103)	(129)	(116)	(116)
Net Income (Adjusted)	651	468	427	518	566
% Change	60.3%	-28.2%	-8.8%	21.4%	9.3%

Free Cash Flow Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	650	471	429	521	569
Depreciation & Amortization	113	127	137	133	139
Change in Working Capital	(91)	(262)	62	(2)	(7)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	50	43	12	57	58
Capital Expenditure	(123)	(307)	(200)	(150)	(150)
Free Cash Flow	600	72	440	558	609
% Change	10.4%	-87.9%	508.6%	26.8%	9.1%
Share / Issue Repurchase	(816)	(667)	(37)	(360)	(360)
Cost of Dividends Paid	(63)	(71)	(78)	(81)	(84)
Change in Debt	979	475	(305)	0	0

Balance Sheet Data (Dec)

(US\$ Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	301	69	89	207	372
Trade Receivables	420	423	413	429	449
Other Current Assets	555	703	650	661	688
Property, Plant & Equipment	584	791	854	871	883
Other Non-Current Assets	2,464	2,374	2,374	2,374	2,374
Total Assets	4,323	4,360	4,380	4,541	4,765
Short-Term Debt	53	70	70	70	70
Other Current Liabilities	1,000	911	911	935	975
Long-Term Debt	2,706	3,193	2,889	2,889	2,889
Other Non-Current Liabilities	270	198	198	198	198
Total Liabilities	4,028	4,372	4,067	4,092	4,132
Total Equity	295	(12)	313	450	633
Total Equity & Liabilities	4,323	4,360	4,380	4,541	4,765

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Retailing-Hardlines

Company Description

Tempur Sealy International is the leading global manufacturer and distributor of bedding products, which includes mattresses, foundations, adjustable bases, and other accessories including pillows. The majority of the company's sales are in the US, of which the company has nearly 40% market share. The company generated \$4.9bn of sales in 2022.

Investment Rationale

In our view, TPX is an attractive multi-year earnings and cash flow growth story. Over the next several years we see several opportunities globally to expand revenues through market share gains, channel DTC expansion and new expanded wholesale partnerships. We see a continued opportunity for dramatically improved margins in all segments under a profit oriented management team and ample internal opportunities.

Stock Data

Average Daily Volume 1,714,308

Quarterly Earnings Estimates

	2022	2023
Q1	0.69A	0.53A
Q2	0.58A	0.58A
Q3	0.78A	0.77A
Q4	0.54A	0.53E

Exhibit 1: TPX pro-forma income statement post-Mattress Firm acquisition

We expect TPX to generate \$3.72/\$4.30 of EPS in 2025/2026 following its acquisition of Mattress Firm

	2025E	2026E
TPX revenue	\$ 5,370	\$ 5,585
Mattress Firm revenue	4,491	4,671
- TPX revenue from Mattress Firm	(832)	(866)
Total revenue	9,029	9,390
Operating income	1,305	1,417
Total interest and other expenses	259	207
Pretax income	1,046	1,210
Income tax expense	259	299
Net income	788	911
Diluted EPS	\$ 3.72	\$ 4.30
Diluted shares outstanding	212	212
EBITDA	1,590	1,702
EBITDA margin	17.6%	18.1%

Source: BofA Global Research estimates, company reports

BofA GLOBAL RESEARCH

Price objective basis & risk

Tempur Sealy International Inc. (TPX)

Our price objective (PO) of \$57.5 is based on 19x our 2024E EPS, which is above TPX's five-year average of 13.5x. We believe this is warranted given TPX's strong competitive position, our expectation that industry trends return to growth next year and TPX can generate over 20% EPS growth in 2024.

Upside risks to our PO are stronger-than-expected sales growth from new products, greater-than-expected margin growth, and quicker than expected growth of direct channels. Downside risks to our PO are unsuccessful new product launches, volatility related to an industry that remains competitive, failure of the pending Mattress Firm acquisition to close and general macroeconomic risk.

Analyst Certification

I, Jason Haas, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Retail Hardline Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Arhaus, Inc.	ARHS	ARHS US	Jason Haas, CFA
	Boot Barn	BOOT	BOOT US	Jason Haas, CFA
	Driven Brands	DRVN	DRVN US	Jason Haas, CFA
	Five Below Inc.	FIVE	FIVE US	Jason Haas, CFA
	Floor and Decor Holdings, Inc.	FND	FND US	Elizabeth L Suzuki
	Genuine Parts	GPC	GPC US	Jason Haas, CFA
	Leslie's	LESL	LESL US	Elizabeth L Suzuki
	Lowe's Companies, Inc.	LOW	LOW US	Elizabeth L Suzuki
	Mattel	MAT	MAT US	Jason Haas, CFA
	Mister Car Wash	MCW	MCW US	Jason Haas, CFA
	Ollie's	OLLI	OLLI US	Jason Haas, CFA
	O'Reilly Automotive, Inc.	ORLY	ORLY US	Jason Haas, CFA
	Petco	WOOF	WOOF US	Jason Haas, CFA
	PROG Holdings Inc	PRG	PRG US	Jason Haas, CFA
	Rollins Inc.	ROL	ROL US	Jason Haas, CFA
	Tempur Sealy International Inc.	TPX	TPX US	Jason Haas, CFA
	The Home Depot, Inc.	HD	HD US	Elizabeth L Suzuki
	Upbound Group Inc.	UPBD	UPBD US	Jason Haas, CFA
NEUTRAL				
	AutoZone Inc.	AZO	AZO US	Jason Haas, CFA
	Hasbro	HAS	HAS US	Jason Haas, CFA
	Sonos, Inc.	SONO	SONO US	Jason Haas, CFA
	Williams-Sonoma	WSM	WSM US	Jason Haas, CFA
UNDERPERFORM				
	Advance Auto Parts, Inc.	AAP	AAP US	Jason Haas, CFA
	Best Buy Co., Inc.	BBY	BBY US	Elizabeth L Suzuki
	Snap-on	SNA	SNA US	Elizabeth L Suzuki
	Tractor Supply Company	TSCO	TSCO US	Jason Haas, CFA
	Whirlpool	WHR	WHR US	Jason Haas, CFA

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
EV = Current Share Price × Current Shares + Minority Equity + Net Debt +
Other LT Liabilities
Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
Market Cap = Current Share Price × Current Basic Shares
Sales

Basic EBIT + Depreciation + Amortization

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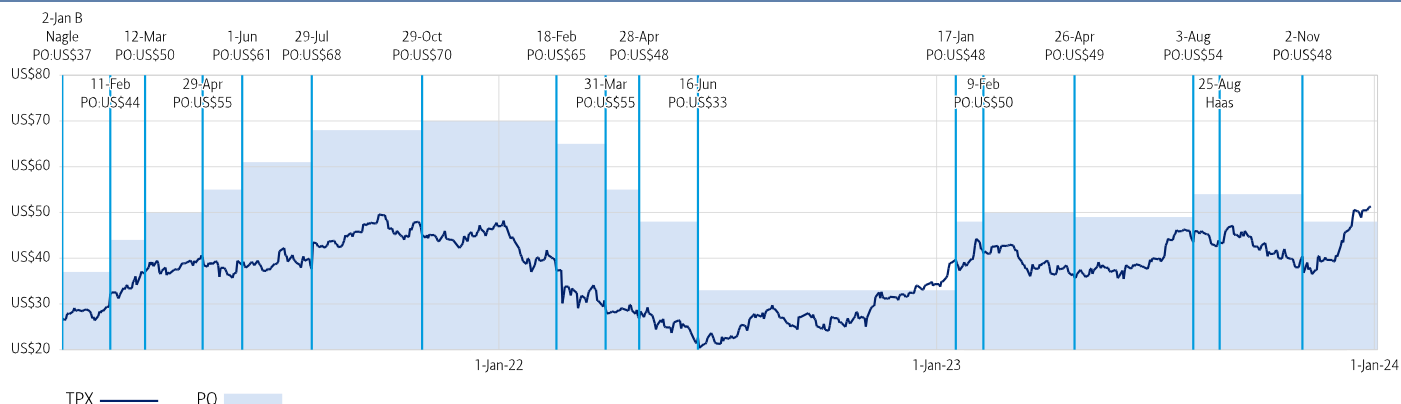
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Tempur Sealy (TPX) Price Chart



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Equity Investment Rating Distribution: Retailing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	96	57.83%	Buy	39	40.63%
Hold	32	19.28%	Hold	12	37.50%
Sell	38	22.89%	Sell	18	47.37%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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