sleep number®

Proxy Statement and Annual Report

Sleep Number Corporation

2018 Annual Meeting

Dear Shareholders,

The future belongs to companies with purpose. At Sleep Number, our differentiated business model is centered on a singular mission of *improving lives by individualizing sleep experiences*.

Our consumer innovation strategy was initiated six years ago in anticipation of the powerful convergence of consumer trends in sleep, technology and health. Since that time, we have invested nearly half a billion dollars to strengthen our competitive advantages: sleep innovation, exclusive distribution, and lifelong customer relationships. In November we also changed our corporate name to Sleep Number Corporation in support of our more broadly relevant brand and long-term value creation.

The integrated strategic company transformation and ongoing evolution is optimizing our culture and opportunities, while considering risks as we drive sustainable growth. Our progress is demonstrated in the superior shareholder returns we have delivered, including 53 percent stock price appreciation over the past five years. Our record 2017 financial results included:

- Net sales of $1.4 billion, up 10% versus the prior year, with positive comparable sales for the fourth consecutive year;
- Net operating profit of $92 million, up 20%; and
- Earnings per share of $1.55, up 41%

We generated record cash flows from operations of $173 million, up 14% versus 2016, while returning $150 million in cash to shareholders through share repurchases. We continue to prioritize high-confidence investments in the business, generating a return on invested capital of more than 14% in 2017 (well above our weighted average cost of capital).

The force behind our strategy is our relentless focus on the consumer. We are committed to understanding, anticipating and adapting to our customers' changing needs. We have disrupted the commoditized mattress industry with "Sleep Tech" that provides life-changing value. We are leading a shift from traditional to disruptive technologies. Our proprietary SleepIQ® technology platform captures more than 4 billion biometric data points every night, making it one of the most comprehensive databases of consumer biometric data. Our proprietary algorithms interpret this data to provide relevant insights to improve our customers' sleep and wellness.

In a world where consumers are taking increasing accountability for their health, our high-quality data combined with individualized adjustability sets us apart. We continued to bring these advantages to consumers in 2017 with the introduction of the most important innovation in our company's 31-year history – the Sleep Number 360® smart bed. With SleepIQ technology as its brain, the 360 smart bed automatically responds to sleepers' biometrics by adjusting the firmness to improve their quality of sleep, while providing individual sleep and biometric data. We will continue to advance the robustness of our sleep data and linkage to overall health as part of our long-term strategic orientation.

Our investment decisions have also supported exclusive distribution. Our direct to consumer approach includes an extraordinary retail experience that has over 550 healthy stores in 50 states with a cohesive online shopping experience. We utilize machine learning models to optimize our direct-to-consumer marketing actions to break through today's noisy and crowded consumer market place. This precision targeting individualizes communications by determining what content will be most effective for specific consumers, thus resulting in a high return on our marketing investments. Our customer relationships are lifelong and these predictive tools help deepen our connections with our loyal customers and attract new consumers to the brand. Today, high-value referral business and repeat customers constitute more than 40% of our revenue.

As a further amplification of how Sleep Number® adjustability and SleepIQ technology improve sleep and performance, we announced a groundbreaking partnership with the National Football League in early 2018. We are now the NFL's official sleep and wellness partner and expect this partnership to generate broader awareness for the Sleep Number brand.

We still have significant opportunity to further improve our customer experience and operating margins as we execute our strategic initiatives. The investments we have made in our technology platforms are enabling increased profitability through faster and more efficient operations. Our teams have embraced lean and six sigma methodologies, implementing process improvements that result in better service, reduced costs, and elimination of waste. We also are on track with multi-year plans to upgrade our supply chain. Pilots to manufacture and deliver pre-assembled beds are validating efficiency, reliability and value improvements. We expect to benefit from continuing gross margin leverage as we realize efficiencies from this network reconfiguration and the full deployment of the Sleep Number 360 line of smart beds.

The future belongs to companies with purpose that is meaningful to consumers. The core of our culture is the dedication to improving lives; we have improved more than 11 million lives with better quality sleep. Our passionate, talented and mission-driven teams comprise the culture that will enable us to achieve our vision of becoming one of the world's most beloved brands by delivering an unparalleled sleep experience. Break-through consumer innovations, like our Sleep Number 360 smart bed, define the future of sleep and shape the future of health and wellness.

Sleep well, dream big,

Shelly Ibach

Shelly Ibach
Sleep Number® setting 40, average SleepIQ® score of 77
President and Chief Executive Officer

sleep number®

1001 Third Avenue South
Minneapolis, Minnesota 55404

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
May 16, 2018

TO THE SHAREHOLDERS OF SLEEP NUMBER CORPORATION:

Sleep Number Corporation will hold its Annual Meeting of Shareholders at **8:30 a.m.** Central Time on **Wednesday, May 16, 2018**. The meeting will be conducted completely as a virtual meeting via the Internet at **www.virtualshareholdermeeting.com/SNBR2018**. The purposes of the meeting are to:

1. Elect three persons to serve as Directors for three-year terms;

2. Cast an advisory vote to approve executive compensation; and

3. Cast an advisory vote to ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the 2018 fiscal year ending December 29, 2018.

Shareholders of record at the close of business on March 21, 2018 will be entitled to vote at the meeting and any adjournments thereof. Your vote is important. Please be sure to vote your shares in favor of the Board of Directors' recommendations in time for our May 16, 2018 meeting date. Your attention is directed to the Proxy Statement for a more complete statement of the matters to be considered at the meeting.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE SHAREHOLDERS' MEETING TO BE HELD ON MAY 16, 2018: The Proxy Statement and Annual Report for the year ended December 30, 2017 and related materials are available at *www.sleepnumber.com/investor-relations*.

By Order of the Board of Directors,

Mark A. Kimball

Mark A. Kimball
Senior Vice President,
Chief Legal and Risk Officer and Secretary

Minneapolis, Minnesota April 6, 2018

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As used in this Proxy Statement, the terms "we," "us," "our," the "company" and "Sleep Number" mean Sleep Number Corporation and its subsidiaries and the term "common stock" means our common stock, par value $0.01 per share.

1001 Third Avenue South
Minneapolis, Minnesota 55404

PROXY STATEMENT
FOR
ANNUAL MEETING OF SHAREHOLDERS

May 16, 2018

FREQUENTLY ASKED QUESTIONS ABOUT THE MEETING AND VOTING

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Sleep Number Corporation for use at the 2018 Annual Meeting of Shareholders.

When is the Annual Meeting and who may attend?

The Annual Meeting will be held at 8:30 a.m. Central Time on Wednesday, May 16, 2018. The meeting will be conducted completely as a virtual meeting via the Internet. Shareholders may attend the meeting, vote their shares and submit questions electronically during the meeting via live webcast by visiting **www.virtualshareholdermeeting.com/SNBR2018**. Our 2018 Annual Meeting will be held completely online to enable greater participation and efficiency for shareholders and the company. Shareholders will need the 16-digit control number included in Notice of Internet Availability of Proxy Materials, on the proxy card or in the instructions that accompanied the proxy materials to enter the annual meeting and to vote their shares at the meeting.

Who is entitled to vote?

Shareholders of record at the close of business on March 21, 2018 (the "Record Date") are entitled to vote at the meeting. As of the Record Date, there were 37,392,488 shares of common stock outstanding. Each share is entitled to one vote on each matter to be voted on at the Annual Meeting. Shareholders are not entitled to cumulative voting rights.

What is the difference between "Shareholders of Record" and "Beneficial Owners"?

If your shares are registered in your name in the records maintained by our stock transfer agent, you are a "Shareholder of Record." If you are a Shareholder of Record, notice of the meeting was sent directly to you.

If your shares are held in the name of your bank, broker, nominee or other holder of record, your shares are held in "street name" and you are considered the "Beneficial Owner." Notice of the meeting has been forwarded to you by your bank, broker, nominee or other holder of record, who is considered, with respect to those shares, the Shareholder of Record. As the Beneficial Owner, you have the right to direct your bank, broker, nominee or other holder of record how to vote your shares by using the voting instructions you received.

If you are a Beneficial Owner and you do not give instructions to the organization holding your shares, then that organization cannot vote your shares and the shares held by that organization will not be considered as present and will not be entitled to vote on any matter to be considered at the Annual Meeting.

How can I receive proxy materials?

We are furnishing proxy materials to our shareholders primarily via the Internet. On or about April 6, 2018, we will begin mailing to certain of our shareholders a Notice of Internet Availability of Proxy Materials (the "Shareholder Notice"), which includes instructions on (i) how to access our Proxy Statement and Annual Report on the Internet, (ii) how to request that a printed copy of these proxy materials be forwarded to you, and (iii) how to vote your shares. If you receive the Shareholder Notice, you will not receive a printed copy of the proxy materials unless you request a printed copy by following the instructions in the Shareholder Notice. All other shareholders will be sent the proxy materials by mail beginning on or about April 6, 2018.

Requests for printed copies of the proxy materials can be made by Internet at http://www.proxyvote.com, by telephone at 1-800-579-1639 or by email at sendmaterial@proxyvote.com by sending a blank email with your control number in the subject line.

What does it mean if I receive more than one proxy card or Shareholder Notice?

If you received more than one proxy card or Shareholder Notice, it generally means you hold shares registered in more than one account. If you received a paper copy of the proxy statement and you choose to vote by mail, sign and return each proxy card. If you choose to vote by Internet or telephone, vote once for each proxy card and/or Shareholder Notice you receive. If you have received more than one Shareholder Notice, vote once for each Shareholder Notice that you receive.

What are shareholders being asked to vote on?

There are three items to be voted on at the meeting:

- The election of three persons to serve as Directors for three-year terms;
- An advisory vote to approve executive compensation; and
- An advisory vote to ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 29, 2018.

What are my voting choices?

For proposal 1, the election of Directors, you may:

- Vote in favor of all nominees;
- Vote in favor of specific nominees and withhold a favorable vote for specific nominees; or
- Withhold authority to vote for all nominees.

For each of proposal 2 (the advisory vote to approve executive compensation) and proposal 3 (the advisory vote to ratify the selection of independent auditors) you may:

- Vote in favor of the proposal;
- Vote against the proposal; or
- Abstain from voting on the proposal.

How does the Board recommend that I vote?

Sleep Number's Board unanimously recommends that you vote your shares:

- **"For"** the election of each of the nominees for Director nominated herein by the Board of Sleep Number;
- **"For"** the advisory vote to approve executive compensation; and
- **"For"** the advisory vote to ratify the selection of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 29, 2018.

How are votes counted?

If you are a Shareholder of Record and grant a proxy by telephone or Internet without voting instructions, or sign and submit your proxy card without voting instructions, your shares will be voted "FOR" each Director nominee and "FOR" each of the other proposals outlined above in accordance with the recommendations of the Board.

Proxies marked "Withhold" on proposal 1 (election of Directors), or "Abstain" on proposal 2 (the advisory vote to approve executive compensation) or proposal 3 (the advisory vote to ratify the selection of independent auditors), will be counted in determining the total number of shares entitled to vote on such proposals and will have the effect of a vote "Against" a Director or a proposal.

If you are a Beneficial Owner and hold your shares in "street name," such as through a bank, broker or other nominee, you generally cannot vote your shares directly and must instead instruct the broker how to vote your shares using the voting instruction form provided by the broker.

What is a Broker Non-Vote?

If a Beneficial Owner does not provide timely instructions, the broker will not have the authority to vote on any non-routine proposals at the Annual Meeting, which includes proposals 1 and 2. Brokers will have discretionary authority to vote on proposal 3 because the ratification of the appointment of independent auditors is considered a routine matter. If the broker votes on proposal 3 (the advisory vote to ratify the selection of independent auditors), but does not vote on another proposal because the broker does not have discretionary voting authority and has not received instructions from the Beneficial Owner, this results in a "broker non-vote" with respect to such other proposal(s).

Broker non-votes on a matter may be counted as present for purposes of establishing a quorum for the meeting, but are not considered entitled to vote on that particular matter. Consequently, broker non-votes generally will have no effect on the outcome of the matter. However, if and to the extent that broker non-votes are required to establish the presence of a quorum at the Annual Meeting, then any broker non-votes will have the same effect as a vote "Withheld" or "Against" any matter that requires approval of a majority of the minimum number of shares required to constitute a quorum for the transaction of business at the Annual Meeting.

What is the vote required to approve each proposal?

Assuming that a quorum is present to vote on each of the proposals, proposals 1, 2, and 3 will require the affirmative vote of holders of a majority of the shares represented and entitled to vote in person or by proxy on such action.

Please note that each of proposals 2 and 3 are "advisory" votes, meaning that the shareholder votes on these items are for purposes of enabling shareholders to express their point of view or preference on these proposals, but are not binding on the company or its Board of Directors and do not require the company or its Board of Directors to take any particular action in response to the shareholder vote. The Board intends to consider fully the votes of our shareholders in the context of any further action with respect to these proposals.

What constitutes a "quorum," or how many shares are required to be present to conduct business at the Annual Meeting?

The presence, in person or by proxy, of the holders of a majority of the outstanding shares of common stock entitled to vote (i.e., at least 18,696,245 shares) will constitute a quorum for the transaction of business at the Annual Meeting. In general, shares of common stock represented by a properly signed and returned proxy card or properly voted by telephone or via the Internet will be counted as shares represented and entitled to vote at the Annual Meeting for purposes of determining a quorum, without regard to whether the card reflects abstentions and withhold votes (or is left blank) or reflects a "broker non-vote" on a matter.

How do I vote my shares?

If you are a *Shareholder of Record* as of the record date, you can vote your shares in any of the following ways:

- Over the *telephone* by calling the toll-free number on the proxy card;
- Over the *Internet* by following the instructions on the proxy card;
- Through the *mail* – if you received a paper copy of the proxy statement, you may vote by mail by signing, dating and mailing your proxy card in the envelope provided; or
- Over the *Internet* during the 2018 annual meeting by going to www.virtualshareholdermeeting.com/SNBR2018 and using your 16-digit control number (included on the Notice of Internet Availability of Proxy Materials, on your proxy card or in the instructions that accompanied your proxy materials).

The telephone and Internet voting procedures have been set up for your convenience. We encourage you to save corporate expense by submitting your vote by telephone or Internet. The procedures have been designed to authenticate your identity, to allow you to give voting instructions, and to confirm that those instructions have been recorded properly.

If you are a *Beneficial Owner* of shares held in "street name," you must vote your shares in the manner prescribed by your bank, broker or other nominee. Your bank, broker or other nominee has provided notice by email or a printed voting instruction card for you to use in directing the bank, broker or nominee how to vote your shares. Telephone and Internet voting are also encouraged for Beneficial Owners who hold their shares in street name.

Beneficial Owners should be aware that brokers are not permitted to vote shares on non-routine matters, including the election of Directors or matters related to executive compensation, without instructions from the Beneficial Owner. As a result, brokers are not permitted to vote shares on proposal 1 (election of Directors) or proposal 2 (the advisory vote to approve executive compensation) without instructions from the Beneficial Owner. Therefore, Beneficial Owners are advised that if they do not timely provide instructions to their bank, broker or other holder of record with respect to proposals 1 or 2, their shares will not be voted in connection with any such proposal for which they do not provide instructions. Proposal 3 (the advisory vote to ratify the selection of independent auditors) is considered a routine matter and, as such, brokers will still be able to vote shares held in brokerage accounts with respect to proposal 3, even if they do not receive instructions from the Beneficial Owner.

Your vote is important. Whether or not you plan to attend the meeting, we urge you to vote your shares in time for our May 16, 2018 meeting date.

May I revoke a proxy and change my vote?

Yes. Any shareholder giving a proxy may revoke it at any time prior to its use at the Annual Meeting by:

- Delivering written notice of revocation to the Corporate Secretary before 6:00 p.m., Eastern Daylight Time, on May 14, 2018;

- Submitting to the Corporate Secretary before 6:00 p.m., Eastern Daylight Time, on May 14, 2018, a properly signed proxy card bearing a later date than the prior proxy card;

- Voting again by Internet or telephone before 11:59 p.m., Eastern Daylight Time, on May 15, 2018; or

- Participating in the Annual Meeting and voting your shares electronically during the Annual Meeting. Participation in the Annual Meeting will not cause your previously granted proxy to be revoked unless you specifically make that request.

Can I receive future proxy materials electronically?

Yes. If you are a Shareholder of Record and you received a paper copy of the proxy materials, you may elect to receive future proxy statements and annual reports online as described in the next paragraph. If you elect this feature, you will receive an email message notifying you when the materials are available, along with a web address for viewing the materials. If you received this proxy statement electronically, you do not need to do anything to continue receiving proxy materials electronically in the future.

Whether you are a Shareholder of Record or a Beneficial Owner holding shares through a bank or broker, you can enroll for future electronic delivery of proxy statements and annual reports by following these steps:

- Go to our website at **www.sleepnumber.com**;

- In the **Investor Relations** section, click on **Electronic Fulfillment**;

- Click on the check-marked box next to the statement **"Shareholders can register for electronic delivery of proxy-related materials."**; and

- Follow the prompts to submit your request to receive proxy materials electronically.

Generally, banks and brokers offering this choice require that shareholders vote through the Internet in order to enroll. Beneficial Owners whose bank or broker is not included in this website are encouraged to contact their bank or broker and ask about the availability of electronic delivery. As is customary with Internet usage, the user must pay all access fees and telephone charges. You may view this year's proxy materials at **www.proxyvote.com.**

What are the costs and benefits of electronic delivery of Annual Meeting materials?

There is no cost to you for electronic delivery of annual meeting materials. You may incur the usual expenses associated with Internet access as charged by your Internet service provider. Electronic delivery ensures quicker delivery, allows you to view or print the materials at your computer and makes it convenient to vote your shares online. Electronic delivery also conserves natural resources and saves the company printing, postage and processing costs.

Who bears the proxy solicitation costs?

The proxies being solicited hereby are being solicited by the Board of Directors of the company. The cost of preparing and mailing the notice of Annual Meeting, this proxy statement and the accompanying proxy and the cost of solicitation of proxies on behalf of the Board of Directors will be borne by the company. The company may solicit proxies by mail, internet (including by email, Twitter, the use of our investor relations website and other online channels of communication), telephone, facsimile and other electronic channels of communication, town hall meetings, personal interviews, press releases, and press interviews. Our Directors, officers and regular team members may, without compensation other than their regular compensation and the reimbursement of expenses, solicit proxies by telephone or personal conversation. In addition, we may reimburse brokerage firms and others for their reasonable and documented expenses incurred in connection with forwarding proxy materials to the Beneficial Owners of our common stock.

STOCK OWNERSHIP OF MANAGEMENT AND CERTAIN BENEFICIAL OWNERS

The following table shows the beneficial ownership of Sleep Number common stock as of February 24, 2018 (unless another date is indicated) by (a) each director, each nominee for director recommended by our Board and each executive officer named in the Summary Compensation Table on page 52 of this Proxy Statement, (b) all directors and executive officers as a group and (c) each person known by us to be the Beneficial Owner of more than 5% of Sleep Number common stock.

Title of Class	Name and Address of Beneficial Owner (1)	Amount and Nature of Beneficial Ownership (2)	Percent of Class
Common Stock	Daniel I. Alegre	20,670	*
Common Stock	Andrea L. Bloomquist (3)	108,175	*
Common Stock	David R. Callen (4)	50,025	*
Common Stock	Andrew P. Carlin (3)	77,232	*
Common Stock	Stephen L. Gulis, Jr. (5)	84,823	*
Common Stock	Michael J. Harrison (5)	43,140	*
Common Stock	Shelly R. Ibach (6)	368,729	*
Common Stock	Suresh Krishna	47,067	*
Common Stock	Brenda J. Lauderback (5)	51,227	*
Common Stock	Barbara R. Matas (5)	9,876	*
Common Stock	Kathleen L. Nedorostek (5)	42,169	*
Common Stock	Vicki A. O'Meara	5,550	*
Common Stock	Michael A. Peel (5)	108,962	*
Common Stock	Jean-Michel Valette	278,191	*
Common Stock	All directors and executive officers as a group (19 persons) (7)	1,660,076	4.3%
Common Stock	BlackRock, Inc. (8) 55 East 52nd Street New York, New York 10055	5,009,987	13.2%
Common Stock	The Vanguard Group, Inc. (9) 100 Vanguard Blvd. Malvern, Pennsylvania 19355	4,025,241	10.6%
Common Stock	Disciplined Growth Investors, Inc. (10) 150 South Fifth Street, Suite 2550 Minneapolis, Minnesota 55402	3,674,807	9.7%
Common Stock	Vulcan Value Partners, LLC (11) 2801 Highway 280 South, Suite 300 Birmingham, Alabama 35223	3,100,206	8.1%

* Less than 1% of the outstanding shares.

(1) The business address for each of the directors and executive officers of the company is c/o Sleep Number Corporation, 1001 Third Avenue South, Minneapolis, Minnesota 55404.

(2) The shares shown include the following shares that directors and executive officers have the right to acquire within 60 days through the exercise of stock options: Mr. Alegre (9,482 shares); Ms. Bloomquist (65,209 shares); Mr. Callen (23,022 shares); Mr. Carlin (46,084 shares); Mr. Gulis (20,357 shares); Mr. Harrison (12,951 shares); Ms. Ibach (235,633 shares); Mr. Krishna (13,407 shares); Ms. Lauderback (20,357 shares); Ms. Matas (2,247 shares); Ms. Nedorostek (15,357 shares); Ms. O'Meara (2,247 shares); Mr. Peel (30,970 shares); and Mr. Valette (20,357 shares). The shares shown also include the following shares that executive officers have the right to acquire within 60 days through the vesting of restricted stock units: Mr. Krishna (14,025 shares).

(3) Includes 8,082 shares held under performance stock grants that have not vested.

(4) Includes 6,060 shares held under performance stock grants that have not vested.

(5) The Amended and Restated 2010 Omnibus Plan (the Plan) permits non-employee directors to receive director fees in the form of common stock in lieu of cash, and to defer receipt of such shares. In addition, the Plan permits non-employee directors to defer receipt of shares of the company's common stock under an Incentive Award granted under the Plan (referred to as Restricted Stock Units or RSUs). The directors are entitled to the deferred shares and fully-vested RSUs upon separation of service from the company. Mr. Gulis's amount includes 49,746 shares that were deferred in lieu of director fees and 14,720 RSUs that were deferred. Mr. Harrison's amount includes 4,689 shares that were deferred in lieu of director fees and 9,328 RSUs that were deferred. Ms. Lauderback's amount includes 9,210 RSUs that were deferred. Ms. Matas' amount includes 4,326 shares that were deferred in lieu of director fees and 2,642 RSUs that were deferred. Ms. Nedorostek's amount includes 12,092 shares that were deferred in lieu of director fees. Mr. Peel's amount includes 10,086 RSUs that were deferred.

(6) Includes 40,407 shares held under performance stock grants that have not vested.

(7) Includes an aggregate of 691,931 shares that directors and executive officers as a group have the right to acquire within 60 days through the exercise of stock options. Includes an aggregate of 91,419 shares held under restricted performance stock grants that have not vested and 14,025 shares that directors and executive officers as a group have the right to acquire within 60 days through the vesting of RSUs. Also includes 70,854 shares that were deferred by non-employee directors in lieu of director fees and 74,616 RSUs that were deferred by executive officers and non-employee directors.

(8) BlackRock, Inc. reported in a Schedule 13G filed with the Securities and Exchange Commission on January 19, 2018 that as of December 31, 2017 it beneficially owned 5,009,987 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 4,923,578 shares and sole dispositive power with respect to 5,009,987 shares.

(9) The Vanguard Group, Inc. reported in a Schedule 13G/A filed with the Securities and Exchange Commission on February 12, 2018 that as of January 31, 2018 it beneficially owned 4,025,241 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 76,295 shares, shared power to vote or to direct the vote with respect to 6,230 shares, shared dispositive power with respect to 78,755 shares and sole dispositive power with respect to 3,946,486 shares.

(10) Disciplined Growth Investors, Inc. reported in a Schedule 13F filed with the Securities and Exchange Commission on February 15, 2018 that as of December 31, 2017 it beneficially owned 3,674,807 shares of Common Stock of Sleep Number Corporation, had sole dispositive power with respect to 3,674,807 shares, sole power to vote or to direct the vote with respect to 3,065,596 shares and no voting power with respect to 609,211 shares.

(11) Vulcan Value Partners, LLC reported in a Schedule 13G/A filed with the Securities and Exchange Commission on February 12, 2018 that as of January 31, 2018 it beneficially owned 3,100,206 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 3,060,697 shares and sole dispositive power with respect to 3,100,206 shares.

ELECTION OF DIRECTORS

(Proposal 1)

Nomination

Article XIV of our Third Restated Articles of Incorporation provides that the number of Directors must be at least one but not more than 12 and must be divided into three classes as nearly equal in number as possible. The exact number of Directors is determined from time-to-time by the Board of Directors. The term of each class is three years and the term of one class expires each year in rotation.

Immediately prior to the 2018 Annual Meeting, our Board will consist of 10 members, three of which will be up for election at the 2018 Annual Meeting. The Board has nominated **Daniel I. Alegre, Stephen L. Gulis, Jr. and Brenda J. Lauderback** for election to the Board, each for a term of three years expiring at the 2021 Annual Meeting, or until their successors are elected and qualified. Mr. Alegre, Mr. Gulis, and Ms. Lauderback have each consented to being named as a nominee in this proxy statement and to serve as a Director if elected. Mr. Alegre has served on our Board since 2013; Mr. Gulis has served on our Board since 2005; and Ms. Lauderback has served on our Board since 2004.

Vote Required

The election of each nominee for Director requires the affirmative vote of a majority of the shares represented and entitled to vote on the election of Directors at the Annual Meeting. Any broker non-votes on the election of each nominee for Director will be treated as shares not entitled to vote on that matter, and thus will not be counted in determining whether the Director has been elected.

Board Recommendation

The Board recommends a vote "**For**" the election of each of Mr. Alegre, Mr. Gulis, and Ms. Lauderback. In the absence of other instructions, properly signed and delivered proxies will be voted "**For**" the election of each of these nominees.

If prior to the Annual Meeting the Board should learn that any nominee will be unable to serve for any reason, the proxies that otherwise would have been voted for such nominee will be voted for such substitute nominee as selected by the Board. Alternatively, the proxies, at the Board's discretion, may be voted for such fewer number of nominees as results from the inability of any such nominee to serve. The Board has no reason to believe that any of the nominees will be unable to serve.

Information about the Board's Nominees and Other Directors

The following table provides information as of the date of this Proxy Statement about each individual serving as a Director of our company and each individual nominated by the Board to serve as a Director. Each Director or Nominee has furnished the information included below that relates to his or her respective age, principal occupation and business experience, as well as the names of other boards on which he or she currently serves as a Director or has served in the past. In addition, the table below highlights the relevant experience, qualifications, attributes and skills that led our Board to conclude that each Director or nominee is qualified to serve as a Director of our company.

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
Nominees for election this year to three-year terms expiring in 2021:		
Daniel I. Alegre Age 49	**Occupation:** President of Global Partner Business Solutions for Google, Inc. since November 2012; Held various roles at Google since 2004, including President of Asia Pacific and Japan, overseeing all regional operations, and Vice President of Latin American and Asia Pacific Business Development; Previously, Mr. Alegre was Vice President at Bertelsmann, responsible for business development of its ecommerce division. **Qualifications:** Mr. Alegre provides the Board with valuable insight into mobile and technology platforms, digital brand building and advertising, and e-commerce deployment and strategy, as well as extensive leadership in global operations and expansion, partner management and business development in technology and mass media industries.	2013
Stephen L. Gulis, Jr. Age 60	**Occupation:** Retired Executive Vice President and President of Global Operations for Wolverine World Wide, Inc. (WWW), a global marketer of branded footwear, apparel and accessories, a position he held from October 2007 until July 2008; Executive Vice President, CFO and Treasurer of WWW from April 1996 until October 2007. **Qualifications:** Mr. Gulis provides the Board with extensive experience as a senior executive of a publicly traded consumer products company, including as a chief financial officer and treasurer with responsibility for capital stewardship and cash management, significant M&A activity and broad oversight of financial reporting and controls. Mr. Gulis also brings expertise in risk management,	2005

	implementation of enterprise technology platforms, global operations, human resources and product sourcing and quality directives. **Other Public Company Boards:** Current: Independent Bank Corporation Prior: Meritage Hospitality	
Brenda J. Lauderback Age 67	**Occupation:** Former President of the Retail and Wholesale Group for the Nine West Group, Inc., a designer and marketer of women's footwear and accessories, from May 1995 until January 1998; Previous roles include President of Wholesale and Manufacturing for US Shoe Corporation and more than 18 years in senior merchandising roles at the Department Store Division of Target Corporation. **Qualifications:** Ms. Lauderback brings to our Board extensive leadership in merchandising, marketing, product development and design and manufacturing at prominent national wholesale and retail companies. Her breadth of experience as a director on several other publicly traded company boards also provides our Board with significant insight into leading practices in executive compensation and corporate governance. Ms. Lauderback is a National Association of Corporate Directors (NACD) Board Leadership Fellow, having completed NACD's comprehensive program of study for directors and corporate governance professionals. She supplements her skill sets through ongoing engagement with the director community, and access to leading practices. Ms. Lauderback was selected as one of the top 100 Directors by NACD in 2017. **Other Public Company Boards:** Current: Denny's Corporation and Wolverine World Wide, Inc. Prior: Big Lots, Inc., Louisiana-Pacific Corporation, Irwin Financial Corporation, Jostens Corporation	2004

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS YOU VOTE "FOR" THE ELECTION OF EACH OF THE NOMINEES LISTED ABOVE

Directors not standing for election this year whose terms expire in 2019:

Michael J. Harrison Age 57	**Occupation:** Board Director since January 2016, and previously interim CEO from March 2014 to May 2015, of OOFOS, LLC, a leader in the emerging global category of recovery footwear for athletes; President & Chief Operating	2011

	Officer of Grand Circle Corporation, a leading overseas travel company serving U.S. travelers age 50+, from August 2016 through January 2017; Board Director of Totes Isotoner Corporation, a leading global marketer of umbrellas, gloves, rainwear, slippers and other weather-related accessories from December 2014 to August 2016; Previously Chief Brand Officer for The Timberland Company, a leading brand of outdoor footwear, apparel and gear from July 2009 through November 2012; Prior to 2009, Mr. Harrison held various senior leadership roles at Timberland and Procter & Gamble Co., including positions with significant responsibility for international marketing, global operations and business development. **Qualifications:** Mr. Harrison brings 30 years of business acumen to our Board from his senior executive experience in marketing, product design and development, retailing and international management with leading consumer brands. **Other Company Boards (privately held):** Current: OOFOS, LLC Prior: Totes/Isotoner Corporation	
Shelly R. Ibach Age 58	**Occupation:** President and Chief Executive Officer of Sleep Number Corporation since June 2012; Executive Vice President and Chief Operating Officer from June 2011 to June 2012; Executive Vice President, Sales & Merchandising from October 2008 to June 2011; Previously held various senior executive operations and merchandising roles at Macy's, Inc. and the Department Store Division at Target Corporation for more than 25 years. **Qualifications:** Ms. Ibach brings experience and perspective as Sleep Number's President and CEO as well as intimate knowledge of our customer, culture, strategy, product, marketing, operations and competitive environment gained during 11 years in executive management with the company. Ms. Ibach also brings more than two decades of retail experience with P&L oversight, brand and product development and customer-focused leadership experience with prominent national retailers.	2012
Barbara R. Matas Age 58	**Occupation:** Former Managing Director and Chairman, Leveraged Finance, Citigroup Global Markets, Inc. from 2013 to 2016, and co-head from 2006 to 2013; From 1985 to 2006 Ms. Matas held various leadership positions in	2016

leveraged finance and high yield capital markets at Citicorp, Salomon Brothers and Citigroup; Ms. Matas began her career as an auditor at Touche Ross & Co.

Qualifications: Ms. Matas brings to our board substantial expertise in capital structure and financial strategy gained through more than 30 years of professional experience in advising boards and management teams on capital markets, capital structure and risk assessment and management.

Other Public Company Boards:
Current: Apollo Investment Corporation

Directors not standing for election this year whose terms expire in 2020:

Kathleen L. Nedorostek Age 65	**Occupation:** Former Global CEO of Nine West Group, a division of Nine West Holdings, Inc., a leading global designer, marketer and wholesaler of brands in apparel, footwear and accessories from April 2014 to September 2014; Group President, Global Footwear and Accessories at The Jones Group from October 2012 until April 2014; President of the North American Wholesale and Global Licensing divisions of Coach Inc. from 2003 to 2012. **Qualifications:** Ms. Nedorostek provides our Board with significant experience leading high-end, multi-national branded consumer products companies with both manufacturing and retail operations. Her experience includes strategic planning for global businesses, P&L oversight, organizational strategy and change management, product design, global licensing and distribution, brand marketing and real estate.	2011
Vicki A. O'Meara Age 60	**Occupation:** Chief Executive Officer of Analytics Pros, Inc., a digital analytics consultancy, since 2014; Executive Vice President of Pitney Bowes, Inc. and President of Pitney Bowes Service Solutions with responsibility for global document management, marketing services and e-commerce units from 2010 to 2013; Previously served for over 10 years in various senior management positions at Ryder Systems, Inc., including as head of Ryder's U.S. Supply Chain Solutions business from 2005 to 2007; Ms. O'Meara's career began as an attorney and Army Captain, and she served in several senior federal government positions.	2016

Qualifications: Ms. O'Meara brings to our Board extensive global leadership and operational experience in a variety of functional areas relevant to our business and strategic direction, including supply chain, digital analytics, marketing, corporate governance, environmental health and safety and government affairs. Ms. O'Meara also brings experience from prior service on two public company boards.

Other Company Boards:
Current: State Farm Mutual Automobile Insurance Company (privately held mutual company)
Prior: Health Management Associates, Inc. and Laidlaw, Inc.

Michael A. Peel Age 68	**Occupation:** Currently serves as Senior Advisor to the leadership advisory firm ghSMART; Previously was an officer of Yale University from October 2008 until July 2017, where he was Vice President of Human Resources and Administration; Prior to joining Yale, Mr. Peel was Chief Human Resources Officer for General Mills, Inc. for 17 years from 1991 - 2008 and last served as Executive Vice President of Human Resources & Global Business Services; Earlier in his career, Mr. Peel spent 14 years at PepsiCo, Inc., where he served as Chief Human Resources Officer for two of its largest and fastest growing divisions, PepsiCo Worldwide Foods and Pepsi-Cola Bottling Group. **Qualifications:** Mr. Peel is a widely recognized Human Capital expert with extensive experience in large, consumer-oriented and publicly traded companies. He has extensive international operating and merger/acquisition/joint venture experience. He provides our Board with senior level perspective on organizational effectiveness, talent development, change management, succession planning, and executive compensation. **Other Public Company Boards:** Current: Pier 1 Imports, Inc.	2003
Jean-Michel Valette Age 57	**Occupation:** Chairman of our Board since May 2010; Independent adviser to branded consumer companies; Currently serves as Lead Director of The Boston Beer Company and as a Director of Intertek Group plc; Served as Chairman of the Board of Directors of Peet's Coffee and Tea, Inc. from January 2004 to October 2012; Also served as non-executive Chairman of the Robert Mondavi Winery from April 2005 to October 2006 and was its Managing Director from October 2004 to April 2005; Head of Branded	1994

Consumer Equity Research and Branded Consumer Venture Capital Investments at Hambrecht & Quist LLC, an investment banking firm, during the 1990s.

Qualifications: Mr. Valette provides our Board with significant, relevant leadership and a proven track record of shareholder value creation with multiple successful branded consumer growth companies as well as valuable perspective in guiding the company on strategy, financial performance and corporate governance practices.

Other Public Company Boards:
Current: Lead Director of The Boston Beer Company
-- Non-Executive Director, Intertek Group plc
Prior: Peet's Coffee and Tea, Inc., Golden State Vintners

David T. Kollat retired from the board when his term expired at the 2016 Annual Meeting of Shareholders, after serving more than 20 years as a Sleep Number Director. Following his retirement from the Board Mr. Kollat was appointed to continue to serve in a non-voting advisory role to the board, as Director Emeritus. In this capacity, Mr. Kollat has received compensation in line with that of non-employee Directors. Mr. Kollat's service as Director Emeritus will terminate following the 2018 Annual Meeting of Shareholders.

Corporate Governance

Information about the Board of Directors and its Committees

The Board of Directors has determined that each of the following Directors who served as a member of our Board during any part of fiscal 2017 is an "independent director" as defined by applicable rules of the NASDAQ Stock Market and the rules and regulations of the Securities and Exchange Commission ("SEC"):

Daniel I. Alegre	Stephen L. Gulis, Jr.	Michael J. Harrison
Brenda J. Lauderback	Barbara R. Matas	Kathleen L. Nedorostek
Vicki A. O'Meara	Michael A. Peel	Jean-Michel Valette

The Board maintains three standing committees, including an Audit Committee, a Management Development and Compensation Committee and a Corporate Governance and Nominating Committee. Each of the committees of the Board has a charter and each of these charters is included in the investor relations section of the company's website at *http://www.sleepnumber.com/sn/en/investor-relations*. The information contained in or connected to our website is not incorporated by reference into or considered a part of this Proxy Statement.

The current members of each of the Board committees are identified in the table below.

Director	Audit Committee	Management Development and Compensation Committee	Corporate Governance and Nominating Committee
Daniel I. Alegre		X	
Stephen L. Gulis, Jr.	Chair		X
Michael J. Harrison		X	X
Brenda J. Lauderback	X	Chair	
Barbara R. Matas	X		
Kathleen L. Nedorostek		X	X
Vicki A. O'Meara	X		
Michael A. Peel		X	Chair
Jean-Michel Valette*			

*In his capacity as non-executive Chairman of the Board, Mr. Valette generally attends all committee meetings.

The Board has determined that each Director serving on a committee meets the independence and other requirements applicable to such committee prescribed by applicable rules and regulations of the NASDAQ Stock Market, the SEC and the Internal Revenue Service.

The Board of Directors has further determined that two current members of the Audit Committee, Stephen L. Gulis, Jr. and Barbara R. Matas, meet the definition of "audit committee financial expert" under rules and regulations of the SEC and meet the qualifications of "financial sophistication" under the Marketplace Rules of the NASDAQ Stock Market. These designations related to our Audit Committee members' experience and understanding with respect to certain accounting and auditing matters are disclosure requirements of the SEC and the NASDAQ Stock Market and do not impose upon any of them any duties, obligations or liabilities that are greater than those generally imposed on a member of our Audit Committee or of our Board of Directors.

The Board of Directors met in person or by telephone conference five times during 2017. The Audit Committee met in person or by telephone conference eight times during 2017. The Management Development and Compensation Committee met in person or by telephone conference eight times during 2017. The Corporate Governance and Nominating Committee met in person or by telephone conference eight times during 2017. All of the members of our Board of Directors serving in 2017 attended 75% or more of all meetings of the Board and committees on which they served during fiscal 2017.

Audit Committee. The Audit Committee is comprised entirely of independent Directors, currently including Stephen L. Gulis, Jr. (Chair), Brenda J. Lauderback, Barbara R. Matas and Vicki A. O'Meara. The Audit Committee provides assistance to the Board in satisfying its fiduciary responsibilities relating to accounting, auditing, operating and reporting practices of our company. The Audit Committee is responsible for providing independent, objective oversight with respect to our company's accounting and financial reporting functions, internal and external audit functions, systems of internal controls regarding financial matters and legal, ethical and regulatory compliance. The responsibilities and functions of the Audit Committee are further described in the Audit Committee Report beginning on page 68 of this Proxy Statement.

Management Development and Compensation Committee. The Management Development and Compensation Committee is comprised entirely of independent Directors, currently including Brenda J. Lauderback (Chair), Daniel I. Alegre, Michael J. Harrison, Kathleen L. Nedorostek and Michael A. Peel. The principal function of the Committee is to discharge the responsibilities of the Board relating to executive compensation and development of current and future leadership resources.

The Committee is responsible for establishing the procedures for setting annual and long-term performance goals for the Chief Executive Officer and for the evaluation by the full Board of his or her performance against such goals. The Committee meets at least annually with the Chief Executive Officer to receive her recommendations concerning such goals. Both the annual goals and the annual performance evaluation of the Chief Executive Officer are reviewed and discussed by the outside Directors at a meeting or executive session of that group. The Committee is also responsible for setting annual and long-term performance goals and compensation for the direct reports to the Chief Executive Officer.

The Committee has the authority under its charter to retain and consult with independent advisors to assist the Committee in fulfilling these responsibilities and duties.

The Committee usually meets four to six times per year in person or by telephone conference as needed. The Chairman of the Committee works with members of our senior management team and with the Committee's independent compensation consultant to determine the agenda for each meeting.

At the beginning of each fiscal year, the Committee reviews and approves compensation for the CEO and each of the other executive officers, which generally includes:

- Changes, if any, to base salaries;

- Establishing the annual cash incentive program, including the target cash incentive levels, the performance measures and goals, and the threshold, target and maximum payout amounts; and

- Establishing the long-term equity incentive program, including the mix of stock options and performance share awards, the performance measures and goals applicable to the performance shares, the threshold, target and maximum payout amounts applicable to the performance shares, any special recognition or retention awards, and the grant levels for each of the executive officers.

In connection with this review and approval, the independent compensation consultant provides relevant market data and trends for the Committee to consider, and the Committee compares each element of total compensation against this market data as it makes compensation decisions.

Following the end of each fiscal year, the Committee reviews and confirms the level of achievement of performance goals previously established for the fiscal year and approves any resulting annual cash incentive or performance share payouts that may be applicable.

Also on an annual basis, the Committee leads the Chief Executive Officer performance evaluation process and reviews the development and succession plans with respect to the entire executive team.

The responsibilities and functions of the Management Development and Compensation Committee, as well as its processes and procedures for consideration and determination of executive and Director compensation, are further described in the Compensation Discussion and Analysis beginning on page 28 of this Proxy Statement.

Corporate Governance and Nominating Committee. The Corporate Governance and Nominating Committee is comprised entirely of independent Directors, currently including Michael A. Peel (Chair), Stephen L. Gulis, Jr., Michael J. Harrison and Kathleen L. Nedorostek. The primary functions of the Corporate Governance and Nominating Committee are to develop and recommend to the Board corporate governance principles to govern the Board, its committees, and our executive officers and team members in the conduct of the business and affairs of our company; to identify and recommend to the Board individuals qualified to become members of the Board and its committees; and to develop and oversee the annual Board and Board committee evaluation process.

Board Leadership Structure

Our Board is currently comprised of nine independent Directors and one executive Director, Shelly R. Ibach, who has served as our President and Chief Executive Officer since June 2012. Since February 2008, the Board has determined to separate the positions of Chairman of the Board and Chief Executive Officer. Based on its ongoing review of best practices in corporate governance, and to enable the President and Chief Executive Officer to focus all of her time and energy in leadership of the day-to-day operations of the company and its growth and profitability initiatives, the Board continues to believe it is best for the company to separate these positions. Jean-Michel Valette, an independent Director, has served as Chairman of the Board since May 2010.

Consistent with the company's Corporate Governance Principles, the Board retains the right to review this determination and to either continue to maintain these positions as separated positions or to combine the positions, as the Board determines to be in the best interests of the company at the time. Under the company's Corporate Governance Principles, during any period in which the positions of Chairman of the Board and Chief Executive Officer are combined, the Board would appoint a Lead Director from among the independent members of the Board, who would have certain Board leadership responsibilities specified in our Corporate Governance Principles.

Board Role in Risk Oversight

Our Board is responsible for overseeing the company's policies and practices with respect to risk assessment and risk management, and has delegated to the Audit Committee the responsibility of assisting the Board in fulfilling this role. Among its duties and processes, the Audit Committee (a) reviews and discusses with management the company's policies and practices with respect to risk assessment and risk management; (b) oversees the company's internal audit function and processes; (c) establishes and oversees procedures for receiving and addressing complaints regarding accounting, internal controls or auditing matters; (d) reviews legal compliance and other legal matters with the company's counsel; and (e) reports to the full Board with respect to matters within its area of responsibility.

The Audit Committee oversees the company's internal audit function, which is responsible for undertaking an annual risk assessment process and reporting to the Audit Committee with respect to this assessment and related risk management strategies. The Audit Committee reviews and approves, at least annually, the company's internal audit plan and receives quarterly reports with respect to the results of internal audits. The leader of the company's internal audit function reports directly to the Audit Committee with respect to internal audit matters, and the Audit Committee has authority to review and approve the appointment, replacement or dismissal of the leader of this function. The leader of the internal audit function meets regularly in executive session with the Audit Committee without any other members of the company's management team present.

In addition to the Audit Committee's role, each of the other committees considers risks within its respective areas of responsibility. We believe our current Board leadership structure helps ensure proper risk oversight, based on the allocation of duties among committees and the role of our independent Directors in risk oversight.

Director Nominations Process

The Corporate Governance and Nominating Committee (the "CGNC") administers the process for nominating candidates to serve on our Board of Directors. The CGNC recommends candidates for consideration by the Board as a whole, which is responsible for appointing candidates to fill any vacancy that may be created between meetings of the shareholders and for nominating candidates to be considered for election by shareholders at our Annual Meeting.

Consistent with the company's Corporate Governance Principles, the CGNC periodically reviews with the Board the appropriate skills and characteristics required of Board members in the context of the current membership of the Board and the strategic direction of the company.

The Board has established selection criteria to be applied by the CGNC and by the full Board in evaluating candidates for election to the Board. These criteria include general characteristics, areas of specific expertise and experience, and considerations of diversity. The general characteristics include:

- Independence;
- Integrity;

- A proven record of accomplishment and sound judgment in areas relevant to our business;

- Belief in and passion for our mission and vision;

- The ability to bring strategic and innovative insights to the discussion and challenge and stimulate management;

- Willingness to both speak one's mind and consider divergent ideas and opinions;

- Understanding of, and ability to commit sufficient time to, Board responsibilities and duties; and

- Subject matter expertise.

The specific areas of expertise and experience sought by the CGNC and the Board from time to time will vary depending on the composition of the Board and the strategic direction of the company at the time, but will generally include CEO experience, executive level experience with analogous businesses and industries, and functional expertise relevant to the strategic direction of the company or the needs of the committees of the Board.

The Director nomination process specifically includes consideration of diversity, such as diversity of age, gender, race and national origin, educational and professional experience and differences in viewpoints. The company does not have a formal policy with respect to diversity. However, the CGNC considers the Board's overall composition when considering Director candidates, including whether the Board has an appropriate combination of professional experience, skills, knowledge and variety of viewpoints and backgrounds in light of the company's current and expected future needs. In addition, the CGNC also believes that it is desirable for new candidates to contribute to a variety of viewpoints on the Board, which may be enhanced by a mix of different professional and personal backgrounds and experiences. Currently, 50% of our Directors are women.

The CGNC reviews these selection criteria and the overall Director nomination process at least annually in connection with the nomination of Directors for election at the company's annual meeting for consistency with best practices in corporate governance and effectiveness in meeting the needs of the Board from time-to-time.

The CGNC may use a variety of methods for identifying potential nominees for election to the Board, including consideration of candidates recommended by Directors, officers or shareholders of the company. The CGNC also has the authority under its charter to engage professional search firms or other advisors to assist the CGNC in identifying candidates for election to the Board, or to otherwise assist the CGNC in fulfilling its responsibilities.

Shareholder nominations of candidates for membership on the Board submitted in accordance with the terms of our Bylaws will be reviewed and evaluated by the CGNC in the same manner as for any other nominations. Any shareholder who wishes the CGNC to consider a candidate should submit a written request and related information to our Corporate Secretary. Under our Bylaws, if a shareholder intends to nominate a person for election to the Board of

Directors at a shareholder meeting, the shareholder is required to give written notice of the proposed nomination to the Corporate Secretary at least 120 days prior to the first anniversary of the date that the company first released or mailed its proxy materials to shareholders in connection with the preceding year's regular or annual meeting. The shareholder's notice must include, for each nominee whom the shareholder proposes to nominate for election as a Director: (i) the name, age, business address and residence address of the nominee, (ii) the principal occupation or employment of the nominee, (iii) the class and number of shares of capital stock of the company that are beneficially owned by the nominee, and (iv) any other information concerning the nominee that would be required under the rules of the Securities and Exchange Commission in a proxy statement soliciting proxies for the election of such nominee. The shareholder's notice must also include: (i) the name and address of the nominating shareholder, as they appear on the company's books, and (ii) the class and number of shares of the company that are owned beneficially and of record by the shareholder. The shareholder's notice must also be accompanied by the proposed nominee's signed consent to serve as a Director of the company.

Shareholder Communications with the Board

Shareholders may communicate with the Board of Directors, its Committees or any individual member of the Board of Directors by sending a written communication to our Corporate Secretary at 1001 Third Avenue South, Minneapolis, MN 55404. The Corporate Secretary will promptly forward any communication so received to the Board, any Committee of the Board or any individual Board member specifically addressed in the communication. In addition, if any shareholder or other person has a concern regarding any accounting, internal control or auditing matter, the matter may be brought to the attention of the Audit Committee, confidentially and anonymously, by calling 1-800-835-5870, inserting the I.D. Code of AUDIT (28348) and following the prompts from the recorded message. The company reserves the right to revise this policy in the event that the process is abused, becomes unworkable or otherwise does not efficiently serve the purposes of the policy.

Policy Regarding Director Attendance at Annual Meeting

Our policy is to require attendance by all of our Directors at our Annual Meeting of Shareholders, except for absences due to causes beyond the reasonable control of the Director. All of the Directors then serving on our Board were in attendance at our 2017 Annual Meeting of Shareholders.

Corporate Governance Principles

Our Board of Directors has adopted Corporate Governance Principles that were originally developed and recommended by the CGNC. These Corporate Governance Principles are available in the investor relations section of the company's website at *http://www.sleepnumber.com/sn/en/investor-relations*. The information contained in or connected to our website is not incorporated by reference into or considered a part of this Proxy Statement. Among these Corporate Governance Principles are the following:

<u>Independence</u>. A substantial majority of the members of the Board should be independent, non-employee Directors. It is the responsibility of the Board to establish the standards for independence and the Board has followed the independence standards for companies

listed on The NASDAQ Stock Market. All of our Directors are independent except Shelly R. Ibach. All Committees of the Board are composed entirely of independent Directors.

Chairman and Chief Executive Officer Positions. At the present time, the Board believes that it is in the best interests of the company and its shareholders for the positions of Chairman of the Board and Chief Executive Officer to be separated, and for the position of Chairman of the Board to be held by a non-executive, independent member of the Board. The Board retains the right to review this determination and to either continue to maintain these positions as separated positions or to combine the positions, as the Board determines to be in the best interests of the company at the time. During any period in which the positions of Chairman of the Board and Chief Executive Officer are combined, the Board will appoint a Lead Director from among the independent members of the Board.

Classified Board Structure. Our Third Restated Articles of Incorporation provide for a classified Board serving staggered terms of three years each. The Board will periodically review its classified Board structure in the context of other provisions and measures applicable to unsolicited takeover proposals with the objective of positioning the Board and the company to maximize the long-term value of our company for all shareholders.

Majority Voting Standard with Resignation Policy for Board Elections. Our Third Restated Articles of Incorporation provide for a majority voting standard in the case of uncontested elections of Directors and a plurality voting standard in the case of contested elections of Directors in order to reduce the risk of a “failed election” in the context of a contested Director election. If a nominee for Director who is an incumbent Director is not elected at a meeting of shareholders and no successor to the incumbent Director is elected at the meeting of shareholders, the incumbent Director shall promptly offer to tender his or her resignation to the Board. The CGNC may make a recommendation to the Board on whether to accept or reject the offer, or whether other action should be taken. The Board shall act on whether to accept the Director’s offer, taking into account the CGNC’s recommendation, and publicly disclose (by press release, a filing with the SEC or other broadly disseminated means of communication) its decision and the supporting rationale within 90 days after the date of the certification of the election results. The CGNC, in making its recommendation, and the Board, in making its decision, may each consider any factors or other recommendations that it considers relevant and appropriate. The incumbent Director who offers to tender his or her resignation shall not participate in the Board’s decision. If such incumbent Director’s offer to tender his or her resignation is not accepted by the Board, such Director shall continue to serve until his or her successor is duly elected, or his or her earlier death, resignation, retirement, disqualification or removal.

Board Diversity. The company does not have a formal policy with respect to diversity. However, the CGNC considers the Board’s overall composition when considering Director candidates, including whether the Board has an appropriate combination of professional experience, skills, knowledge and variety of viewpoints and backgrounds in light of the company’s current and expected future needs. In addition, the CGNC believes that it is desirable for new candidates to contribute to a variety of viewpoints on the Board, which may be enhanced by a mix of different professional and personal backgrounds and experiences.

Approach to Term and Age Limits. We believe that specific or fixed term or age limits could cause the company to arbitrarily lose important contributors to the Board. It is the sense of the Board, however, that a Director who reaches the age of 72 should promptly tender his or her resignation to the Chair of the CGNC, and the Board should have an opportunity to review the qualifications of the Director for continued Board membership. The CGNC will review the qualifications of the Director for continued Board membership annually and make a recommendation to the Board each year, which will make a final determination with respect to the tendered resignation.

Change in Responsibilities. Directors who retire or who have a change in their principal employment or affiliation after joining the Board should not necessarily leave the Board. There should, however, be an opportunity for the Board to review the qualifications of the Director for continued Board membership. Any Director who undergoes a material change in principal employment or affiliation will promptly tender his or her resignation to the Chair of the CGNC. The CGNC will review the qualifications of the Director for continued Board membership and make a recommendation to the Board, which will make a final determination with respect to the tendered resignation.

Other Board or Audit Committee Service. The Board recognizes that service on other boards can in some circumstances limit the time that Directors may have to devote to fulfilling their responsibilities to the company. It is the Board's guideline that no Director shall serve on more than a total of six public company boards (including the Sleep Number Board), and that no member of the company's Audit Committee shall serve on more than a total of three public company audit committees (including the Sleep Number Audit Committee). If any Director exceeds or proposes to exceed these guidelines, the Director is required to promptly notify the Chair of the CGNC and the committee will review the facts and circumstances and determine whether such service would interfere with the Director's ability to devote sufficient time to fulfilling the Director's responsibilities to the company. Currently, none of the Directors serve on more than three public company boards, including the Sleep Number Board.

Chief Executive Officer Service on Other Boards. The Chief Executive Officer may not serve on more than two public company boards other than the Sleep Number Board of Directors.

Board and Committee Evaluations. The Board believes that the company's governance and the Board's effectiveness can be continually improved through evaluation of both the Board as a whole and its committees. The CGNC is responsible for annually evaluating effectiveness in these areas and reviewing the results and recommendations for improvement with the full Board.

Board Executive Sessions. Executive sessions or meetings of independent Directors without management present will be held at least twice each year. At least one session will be to review the performance criteria applicable to the Chief Executive Officer and other senior managers, the performance of the Chief Executive Officer against such criteria, and the compensation of the Chief Executive Officer and other senior managers. Additional executive sessions or meetings of outside Directors may be held from time-to-time as required. The Board's practice has been to meet in executive session for a portion of each regularly scheduled meeting of the Board. Any member of the Board may request at any time an executive session without the presence of management.

Paid Consulting Arrangements. The Board believes that the company should not enter into paid consulting arrangements with independent Directors.

Board Compensation. Board compensation should encourage alignment with shareholders' interests and should be at a level equitable to comparable companies. The Management Development and Compensation Committee is responsible for periodic assessments to assure these standards are being met.

Share Ownership Guidelines for Executive Officers and Directors. The Board has established the stock ownership guidelines described below for executive officers and Directors. For purposes of these guidelines, stock ownership includes the fair market value of (1) all shares of common stock owned outright, (2) unvested restricted stock and restricted stock units that are subject only to time-vesting, net of an assumed effective tax rate of 40%, and (3) vested stock options, net of an assumed effective tax rate of 40%. The fair market value of stock options shall mean the then-current market price less the exercise price. Unvested performance shares, whether in the form of restricted stock or restricted stock units, will not count toward stock ownership.

- *Executive Officer Ownership Guidelines*. The Chief Executive Officer is expected to achieve and maintain stock ownership equal to five times the Chief Executive Officer's base salary and each of the other executive officers is expected to achieve and maintain stock ownership equal to three times the executive officer's base salary. The executive officers are required to retain at least 50% of net shares after taxes from any grant until such time as the guideline is met.

- *Board Ownership Guidelines*. Within five years of joining the company's Board of Directors, each Director is expected to achieve and maintain stock ownership equal to five times the Director's annual cash retainer. Any Director who has not achieved the foregoing ownership objective by the required time period will not be permitted to sell any shares except to the extent required to pay the exercise price, transaction costs and taxes applicable to the exercise of stock options or the vesting of restricted shares. Exceptions to these restrictions on sale of shares may be granted by the Board in its sole discretion for good cause shown by any Director.

Prohibition of Hedging or Pledging of Shares. Under our policy with respect to trading in the company's securities, Directors, officers and other team members whose duties regularly bring them into contact with confidential or proprietary information ("insiders") are prohibited from engaging in any form of hedging or monetization transactions involving the company's securities. In addition, insiders are prohibited from engaging in short sales of the company's securities and from trading in any form of publicly traded options, puts, calls or other derivatives of the company's securities. Insiders are also prohibited from engaging in any form of pledging of the company's securities, including (i) purchasing company securities on margin; (ii) holding company securities in any account which has a margin debt balance; (iii) borrowing against any account in which company securities are held; or (iv) pledging company securities as collateral for a loan.

Conflicts of Interest. Directors are expected to avoid any action, position or interest which conflicts with an interest of the company, or that gives the appearance of a conflict. If any member of the Board becomes aware of any such conflicting or potentially conflicting interest involving any member of the Board, the Director should immediately bring such information to the attention of the Chairman of the Board, the Chief Executive Officer and the General Counsel of the company.

Performance Goals and Evaluation. The Management Development and Compensation Committee is responsible for establishing the procedures for setting annual and long-term performance goals for the Chief Executive Officer and for the evaluation by the full Board of his or her performance against such goals. The Committee meets at least annually with the Chief Executive Officer to receive his or her recommendations concerning such goals. Both the annual goals and the annual performance evaluation of the Chief Executive Officer are reviewed and discussed by the outside Directors at a meeting or executive session of that group. The Committee is also responsible for setting annual and long-term performance goals and compensation for the direct reports to the Chief Executive Officer.

Compensation Philosophy. The Board supports and, through the Management Development and Compensation Committee, oversees team member compensation programs that are closely linked to business performance and emphasize equity ownership.

Senior Management Depth and Development. The Chief Executive Officer reports to the Board, at least annually, on senior management depth and development, including a discussion of assessments, leadership development plans and other relevant factors.

Provisions Applicable to Unsolicited Takeover Attempts or Proposals. The Board will periodically review (not less often than every three years) the company's Third Restated Articles of Incorporation and Bylaws and various provisions that are designed to maximize shareholder value in the event of an unsolicited takeover attempt or proposal. Such review includes consideration of matters such as the company's state of incorporation, whether the company should opt in or out of applicable control share acquisition or business combination statutes, and provisions such as the company's classified Board structure. The objective of this review is to maintain a proper balance of provisions that will not deter bona fide proposals from coming before the Board, and that will position the Board and the company to maximize the long-term value of our company for all shareholders.

Shareholder Approval of Equity-Based Compensation Plans. Shareholder approval will be sought for all equity-based compensation plans.

Code of Conduct

We have developed and circulated to all of our team members a Code of Business Conduct addressing legal and ethical issues that may be encountered by our team members in the conduct of our business. Among other things, the Code of Business Conduct requires that our team members comply with applicable laws, engage in ethical and safe conduct in our work environment, avoid conflicts of interests, conduct our business with integrity and high ethical standards, and safeguard our company's assets. A copy of the Code of Business Conduct is included in the investor relations section of our website at *http://www.sleepnumber.com/sn/en/investor-relations*. We intend to disclose any amendments to and any waivers from a provision of our Code of Business Conduct on our website. The information contained in or connected to our website is not incorporated by reference into or considered a part of this Proxy Statement.

Team members are required to report any conduct that they believe in good faith violates our Code of Business Conduct. The Code of Business Conduct also sets forth procedures under which team members or others may report through our management team and, ultimately, directly to our Audit Committee (confidentially and anonymously, if so desired) any questions or concerns regarding accounting, internal accounting controls or auditing matters.

All of our team members are required to periodically certify their commitment to abide by our Code of Business Conduct. We also provide training in key areas covered by the Code of Business Conduct to help our team members to comply with their obligations.

Related Party Transactions Policy

The Board of Directors has adopted a written policy intended to ensure the proper approval and reporting of transactions between the company and any of its Directors, nominees for Director, executive officers or significant shareholders or entities or persons related to them that would be required to be disclosed by the company pursuant to Item 404 or Regulation S-K of the Federal securities laws. Under this policy, any proposed or existing related party transaction is subject to the approval or ratification of the Corporate Governance and Nominating Committee. A copy of the Related Party Transactions Policy can be accessed through our Investor Relations website at *http://www.sleepnumber.com/sn/en/investor-relations*. The information contained in or connected to our website is not incorporated by reference into or considered a part of this Proxy Statement. There were no related party transactions during the year ended December 30, 2017 and there are none currently contemplated.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS AND COMPENSATION DISCUSSION AND ANALYSIS

COMPENSATION COMMITTEE REPORT

The Management Development and Compensation Committee of the Board of Directors (the "Committee"), consisting entirely of independent directors, has reviewed and discussed the following Compensation Discussion and Analysis with management and, based on this review and discussion, the Committee recommended to the Board that the Compensation Discussion and Analysis be included in this Proxy Statement.

The Management Development and Compensation Committee

Brenda J. Lauderback, Chair
Daniel I. Alegre
Michael Harrison
Kathleen L. Nedorostek
Michael A. Peel

This Compensation Committee Report shall not be deemed to be "filed" with the Securities and Exchange Commission or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended. Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate future filings, in whole or in part, this Compensation Committee Report shall not be incorporated by reference into any such filings.

COMPENSATION DISCUSSION AND ANALYSIS

Introduction

This Compensation Discussion and Analysis (CD&A) describes the key principles and programs used to determine the compensation of the named executive officers (NEOs) for fiscal 2017 (January 1, 2017 through December 30, 2017) and explains how the company's practices align with our pay for performance philosophy.

For fiscal 2017, our NEOs were:

NAME	PRINCIPAL POSITION
Shelly R. Ibach	President & Chief Executive Officer (CEO)
David R. Callen	Senior Vice President & Chief Financial Officer (CFO)
Andrew P. Carlin	Executive Vice President & Chief Sales and Services Officer
Andrea L. Bloomquist	Senior Vice President & Chief Product Officer
Suresh Krishna	Senior Vice President & Chief Operations, Supply Chain and Lean Officer

Our CD&A is divided into the following sections:

- Executive Summary
- Compensation Governance
- Compensation Framework and Actions
- Executive Compensation Tables

Executive Summary

Compensation Philosophy:

Sleep Number's executive compensation philosophy is to provide compensation opportunities that attract, retain and motivate talented key executives to deliver sustainable profitable growth. Our program generally consists of a fixed base salary, variable performance-based cash incentive and long-term equity awards including performance units and stock option grants. Our program is designed to align executive compensation with shareholder interests by:

- Evaluating the effectiveness of compensation programs in motivating superior competitive performance when compared with both industry peers and other admired specialty retailers;
- Establishing performance goals with consideration for our strategic plan and recent peer group and broader industry growth and earnings benchmarks, with the objective of requiring above-median performance for above median compensation;
- Linking annual incentive awards to the achievement of key financial, strategic and operational goals which closely correlate with shareholder value creation; and
- Providing opportunities for company executives to earn meaningful performance-based equity incentive awards tied to the achievement of pre-established long-term (3 years) performance goals and stock price appreciation.

Sleep Number's pay for performance philosophy is clearly reflected in CEO compensation, which is nearly 80% variable with company performance. CEO compensation is weighted most heavily towards equity-based long-term incentive compensation (55% of target total compensation) and the annual cash incentive (24% of target total compensation). Equity-based long-term incentives and the annual cash incentive are directly tied to achievement of key financial, strategic and operating performance objectives.

The long-term equity-based awards are tied to growth in revenue (or net sales) and growth in net operating profit (NOP) and return on invested capital (ROIC). The ROIC objective was added by the Management Development and Compensation Committee (for the purposes of this CD&A,

the "Committee") beginning in 2015 to ensure that payouts under the long-term equity-based awards are reduced if capital investments in the business do not generate returns that are sufficiently above the company's weighted average cost of capital (WACC). All standard annual and long-term incentive awards include performance thresholds that must be met before any payout may be made. The annual cash incentive is dependent on achieving an Adjusted EBITDA performance objective and is awarded to motivate and reward performance of a large portion of the company's team member population, including the NEOs. As discussed below, the payout for 2017 performance was based on an Adjusted EBITDA measure.

We define Adjusted EBITDA as net income plus: income tax expense, interest expense, depreciation and amortization, stock-based compensation and asset impairments (as detailed in our quarterly and annual financial filings). For a description of how we calculate Adjusted EBTIDA from Net Income and how we calculate ROIC, see "Non-GAAP Data Reconciliations" of our Annual Report on Form 10-K filed on February 27, 2018.

2017 Performance and Incentive Payouts:

In 2017, we delivered revenue and profit growth above plan. This performance resulted in a 66% Total Shareholder Return (TSR)* for the year. As shown in the table below, both 2017 and 2015-2017 TSR meaningfully exceeded both the S&P 400 Specialty Store Index and our peer group**. Our 2017 one-year and three-year compound annual growth in revenue (or net sales), Adjusted EBITDA, NOP, EPS (or Earnings Per Share), and TSR is summarized below.

		2017 Growth	2015 - 2017 Growth CAGR
Sleep Number Performance	Revenue	10%	8%
	Adjusted EBITDA	16%	4%
	Net Operating Profit	20%	-3%
	Earnings Per Share (EPS)	41%	7%
	Total Shareholder Return (TSR)	66%	12%

S&P 400 Specialty Stores Index TSR	-23%	-13%
Peer Group TSR	1%	5%

* Total Shareholder Return refers to the percentage change in the value of a shareholder's investment in the company over the relevant time period, as determined by dividends paid and the change in the company's share price during the period.

** Our peer group is described and defined in more detail under the section "Benchmarking Using Compensation Peer Groups."

The impact of our performance on both the Annual Incentive Plan and the Long-Term Incentive Plan is summarized below:

- **Long-Term Incentive Awards, earned for 2015-2017 performance:** The awards for the three-year period were earned at 86% of target based on revenue and NOP growth for fiscal years 2015-2017. This result reflected above-target revenue growth for all three years and below-target NOP growth in 2015 and 2016. The 2015 and 2016 below-target NOP performance is primarily attributable to the impact of significant investments in our business during this period that are essential to our long-term strategy.

As shown in the chart below, the three-year performance-vested long-term incentive program demonstrates the pay-for-performance orientation of our compensation philosophy and program design. These long-term incentive program provides an opportunity for company executives to earn meaningful performance-based incentive awards tied to the achievement of pre-established performance goals.

Grant Year **Performance Period End**	**2011*** **2013**	**2012** **2014**	**2013** **2015**	**2014** **2016**	**2015** **2017****
Performance Metric(s)	Market Share Free Cash Flow	Market Share	Net Sales NOP Margin	Net Sales Growth NOP Growth	Net Sales Growth NOP Growth ROIC Modifier
3-Year Revenue Growth CAGR	17%	16%	9%	11%	8%
3-Year NOP Growth CAGR	20%	4%	-16%	-5%	-3%
Final Payout % of Target	**85%**	**40%**	**20%**	**85%**	**86%**

Performance-Vested RSU % of Total LTI Grant Value	50%	50%	50%	75%	75%

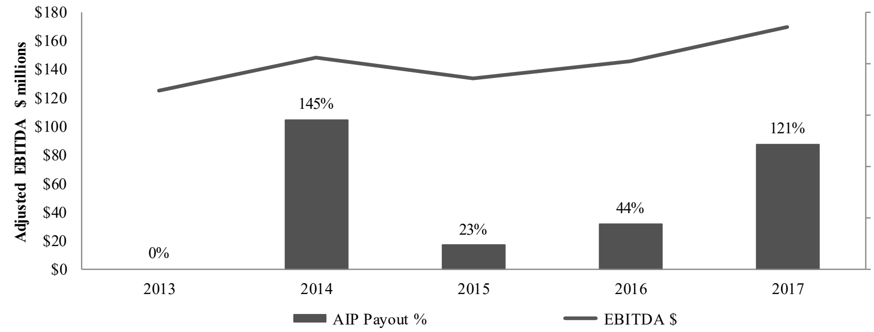
* 2011 was the first year we granted performance-vested long-term incentive awards.

** Performance-vested LTI metrics and % of total grant value for 2016 and 2017 awards is the same as 2015.

- **2017 Annual Incentive Plan (AIP) payouts:** With 2017 Adjusted EBITDA growth of 16%, we exceeded our target level of performance. As a result, the AIP payout was earned at 121% of target for 2017, and the annual total cash compensation was close to the median of the market.

The annual cash incentive payouts relative to Adjusted EBITDA performance over the past 5 years also demonstrates alignment to pay for performance, as outlined below:

2013 - 2017 Adjusted EBITDA and Annual Incentive Payout



	2013	2014	2015	2016	2017
Adjusted EBITDA Growth % (+/-)	-17%	19%	-10%	9%	16%

For discussion of the revenue growth and NOP growth targets and payouts under the 2014-2016 plan, see the company’s 2017 proxy statement, filed with the SEC on April 4, 2017; for discussion of the revenue growth and NOP margin growth targets and payouts under the 2013-2015 plan, see the company's 2016 proxy statement, filed with the SEC on April 1, 2016; for a discussion of the market share targets under the 2012-2014 plan, see the company’s 2015 proxy statement, filed with the SEC on March 31, 2015, and for a discussion of the market share and free cash flow targets under the 2011-2013 plan, see the company’s 2014 proxy statement, filed with the SEC on April 4, 2014.

Compensation Governance

Our compensation programs are structured to align the interests of our executive officers with the interests of our shareholders. They are designed to attract, retain and motivate a talented management team to deliver on the company’s strategic and operational goals, capitalize on our competitive advantages and achieve sustainable profitable growth. Key objectives include:

- Performance-Based Compensation. We believe that linking pay to performance is judicious, and as a result, we favor variable compensation that is tied to company performance. We target total direct compensation near the market median, with the opportunity to earn total direct compensation above the market median when company and/or individual performance exceeds performance objectives.

- Company and Individual Achievement. In determining annual cash and equity incentive awards, emphasis is placed on achievement of specific company performance objectives. However, we may also recognize and reward superior individual performance, primarily through merit increases in base salaries and long-term equity awards.

- Stock Ownership. We believe that team member stock ownership is critical in aligning the interests of team members with those of our shareholders. The company has established specific stock ownership guidelines for executive officers as well as for members of the

Board of Directors. The company also provides opportunities for broader team member stock ownership through our long-term incentive plans and our 401(k) savings plan.

Practices and Policies

In order to meet the key objectives of our executive compensation program, the company has adopted a strong corporate governance framework with the following practices and policies that ensure alignment of interests between shareholders and executives.

COMPENSATION PRACTICE	SLEEP NUMBER POLICY	
Pay for performance	YES	A significant percentage of the total direct compensation package is performance-based.
Robust stock ownership guidelines	YES	We have stock ownership guidelines for executive officers and Board members. Executive officers & Directors are expected to achieve and maintain stock ownership of: • 5x base salary for the CEO • 3x base salary for non-CEO executive officers, and • 5x annual cash retainer for Board members Executives are required to hold 50% of the after-tax value delivered from LTI vesting and option exercise until meeting the guideline level of ownership. Directors are expected to achieve the guideline level of ownership within 5 years of the appointment to the Board. Unearned performance-vested awards are not included in the ownership calculation.
Annual shareholder "Say on Pay"	YES	We value our shareholders' input on our executive compensation programs. Our Board of Directors seeks an annual non-binding advisory vote from shareholders to approve the executive compensation disclosed in our CD&A, tabular disclosures and related narrative of this proxy statement.
Annual compensation risk assessment	YES	A risk assessment of our compensation programs is performed on an annual basis.
Clawback policy	YES	Our policy allows recovery of incentive cash and earned equity compensation in the event of inaccurate financial statements or other actions that would constitute "cause" or "adverse action." In addition, certain participants are subject to automatic forfeiture in connection with misconduct resulting in an accounting restatement.
Independent compensation consultant	YES	The Committee retains an independent compensation consultant to advise on the executive compensation program and practices.
Double-trigger vesting	YES	An executive officer's unvested equity awards will vest upon a change in control only if the executive also experiences a qualifying termination of employment or significant diminution in role.
Hedging of company stock	NO	Executive officers and members of the Board of Directors may not directly or indirectly engage in transactions intended to hedge or offset the market value of Sleep Number common stock owned by them.

Pledging of company stock	NO	Executive officers and members of the Board of Directors may not directly or indirectly pledge Sleep Number common stock as collateral for any obligation.
Tax gross-ups	NO	We do not provide tax gross-ups on any benefits or perquisites, other than for relocation benefits that are applied consistently for all team members.
Repricing of stock options	NO	Our equity incentive plan does not permit repricing of stock options without shareholder approval or the granting of stock options with an exercise price below fair market value.
Employment contracts	NO	None of our current named executive officers has an employment contract that provides for continued employment for any period of time.

Shareholder Engagement

As part of its commitment to strong corporate governance, the company's management team and its Board of Directors maintain an active shareholder relations effort to help foster effective engagement. We conduct shareholder meetings and calls that include direct shareholder contact with management and our board. The purpose of our communication is to drive the sustainable, long-term growth of the company and shareholder value. These productive conversations, as well as our commitment to long-term value creation and pay for performance, will continue to inform the Committee's decisions related to executive compensation in 2018 and beyond.

Board Compensation Committee and Independent Consultant

The Committee is comprised entirely of independent, non-employee directors. The responsibilities of the Committee include:

- Review and approve the company's compensation philosophy
- Establish executive compensation structure and programs designed to motivate and reward superior company performance
- Lead the Board of Directors' annual process to evaluate the performance of the Chief Executive Officer
- Determine the composition and value of compensation for the Chief Executive Officer and other executive officers including base salaries, annual cash incentive awards, long-term equity-based awards, benefits, and perquisites
- Establish, administer, amend and terminate executive compensation and major team member benefit programs

- Assess management development progress and talent depth, organizational strategy, and succession planning for key leadership positions in the context of the company's strategic, operational and financial growth objectives

- Establish structure and amount of non-employee director compensation

Under its charter, the Committee has the authority to retain and consult with independent advisors to assist in fulfilling these responsibilities and duties. To maintain the independence of these advisors, use by the company of any of these advisors for work other than that expressly commissioned by the Committee must be approved in advance by the Committee.

Since fiscal 2013, the Committee has retained the firm of Frederic W. Cook & Co., Inc. ("FW Cook") as its independent compensation consultant. At the Committee's request, FW Cook provided information addressing its independence as well as the independence of its individual advisors, including the following disclosures:

- Any other services it provides to the company;

- Fees paid by the company as a percentage of the consulting firm's total revenue;

- Policies and procedures adopted by the consulting firm to prevent conflicts of interest;

- Any business or personal relationships between the individual compensation advisors and a member of the Committee;

- Any company stock owned by the individual compensation advisors; and

- Any business or personal relationships between Sleep Number's executive officers and the individual compensation advisors or consulting firm.

The Committee assessed these factors in light of SEC rules and NASDAQ listing standards and concluded that no conflict of interest or independence concerns exist in the engagement of FW Cook as Sleep Number's independent compensation consultant.

In the course of its engagement, the independent compensation consultant:

- Provides on-going assessment of each of the principal elements of the company's executive compensation program;

- Advises the Committee on the design of both the annual cash incentive plan and the long-term equity incentive program;

- Works with the Committee and representatives of senior management to assess and refine the company's peer group for ongoing comparative analysis purposes;

- Provides the Committee with updates related to regulatory and legislative matters;

- Reviews market data, trends and analyses from general industry and proxy peer group surveys to inform executive compensation levels and design; and

- Provides advice and guidance to the Committee on pay actions for executives.

The Committee usually meets four to six times per year in person, or by telephone conference as needed. The Chair of the Committee works with members of our senior management team and with the Committee's independent compensation consultant to determine the agenda for each meeting. Following the development of the agenda, members of senior management and our human resources function, along with the Committee's independent compensation consultant, prepare materials for each meeting of the Committee. These materials are typically reviewed with the Chair of the Committee in advance of distribution to the entire Committee. Our Chief Executive Officer, other members of our management team involved in the development and administration of our compensation programs and the Committee's independent compensation consultant may be invited to attend all or a portion of a Committee meeting, depending on the nature of the agenda. The Committee also typically meets in executive session without any members of management present.

Neither our Chief Executive Officer nor any other member of our management team votes on any matters before the Committee. The Committee, however, solicits the views of our Chief Executive Officer on compensation matters generally, other than her own, and particularly with respect to the compensation of members of the senior management team reporting to the Chief Executive Officer. The Committee also solicits the views of other members of senior management and the company's human resources department on topics related to key compensation elements and broad-based team member benefit plans.

Benchmarking Using Compensation Peer Groups

In determining each executive's annual total direct compensation, the Committee considers peer group market positioning, utilizing relevant market data developed by management and reviewed by FW Cook. The market data are developed from the Towers Watson Compensation Data Bank (CDB), General Industry Executive Compensation Survey Report and from compensation data obtained from publicly available proxy statements for an industry peer group.

The Committee, in consultation with FW Cook, annually reviews the composition of the industry peer group to ensure that the included companies are appropriate in terms of size and business focus. The selected peer group generally consists of publicly traded industry competitors, as well as a representative group of similarly sized companies involved in development, manufacturing and/or retailing of home furnishings and other consumer durable products, with which we compete for talent and for shareholder investments. To ensure that our peer group includes companies of appropriate size and scope, we generally aim to select peers whose net sales, EBITDA and market capitalization are within a range of one-half to two times our own comparable metrics.

While the Committee prefers to limit changes to the composition of the peer group year-over-year, industry merger and acquisition activity, and/or significant shifts in peer business strategy and performance over time may prompt peer group changes. One or more of these factors affected peer group companies during the past year, and as a result, we removed the following companies from our peer group in September 2017:

- Mattress Firm Holding Corp.
- Kate Spade and Company
- Lumber Liquidators Holdings Inc.
- Kirkland's, Inc.

Prior to this action, these companies were included in our peer group and were therefore part of the competitive analysis used for compensation decisions made in March 2017. Also in September 2017, the Committee added three new companies: Aaron's, Inc., Dolby Laboratories, Inc., and Leggett & Platt, Incorporated. We believe that each of these companies represents an appropriate size and business focus to be a member of our peer group. As a result, our current peer group for benchmarking executive compensation going forward consists of the following 15 companies:

- Aaron's, Inc.
- Container Store Group, Inc.
- Columbia Sportswear Co.
- Deckers Outdoor Corp.
- Dolby Laboratories, Inc.
- Ethan Allen Interiors Inc.
- Express Inc.
- Haverty Furniture Companies Inc.
- La-Z-Boy Inc.
- Leggett & Platt, Incorporated
- Pier 1 Imports Inc.
- Restoration Hardware Holdings Inc.
- Steven Madden Ltd.
- Tempur Sealy International Inc.
- Vitamin Shoppe Inc.

Compensation Risk Assessment

The company has established an annual process to assess whether its compensation practices are reasonably likely to have a material adverse effect on the company. This process includes:

- Compilation of a comprehensive inventory of the company's compensation policies, practices and programs;
- Identification of potential areas of risk by members of a cross-functional team, comprised of internal company representatives from Legal, Human Resources and Risk Management;
- Review of compensation programs in light of risks identified;
- Review of plans and controls in place to mitigate potential risks;
- Review of the assessment process and cross-functional team's conclusions by FW Cook; and
- Review of the assessment process and conclusions by the Committee with members of the senior management team and FW Cook representatives.

Based on this assessment, the company has determined that none of its compensation policies, practices or programs is reasonably likely to have a material adverse effect on the company.

Results of 2017 Advisory Vote to Approve Executive Compensation

We welcome communication with shareholders and value their viewpoints. At our 2017 Annual Meeting, our shareholders approved our Say on Pay proposal in support of our executive compensation program, with more than 99 percent of the votes cast by our shareholders on this proposal in favor of the "say on pay" vote (excluding broker non-votes). The Committee believes that these voting results affirm shareholder support of our approach to executive compensation.

Compensation Framework and Actions

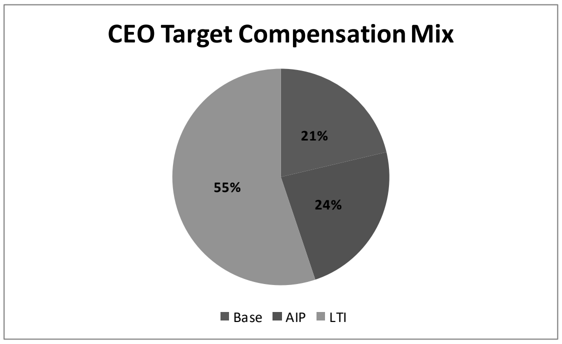
Compensation Program Elements and 2017 Actions

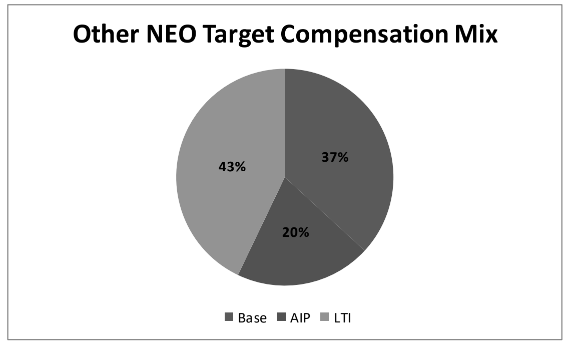
Our executive compensation program is designed to attract, motivate, reward and retain the senior management talent required to achieve our corporate objectives and create long-term value for our shareholders. We do not have employment agreements with any of our executive officers that provide for continued employment for any period of time. Our program currently consists of the following key elements:

- Base salary;
- Annual cash incentive compensation;
- Long-term equity-based incentive compensation;
- Non-qualified deferred compensation plan;
- Broad-based benefit plans available to other team members generally;
- Limited perquisites; and
- Severance compensation upon termination of employment under certain circumstances.

With the assistance of FW Cook, the Committee uses target and actual payouts for incentive compensation to value the total compensation of executive officers and assess its competitive positioning. This competitive analysis is just one factor considered when making compensation decisions. However, the Committee generally seeks to align target compensation opportunities with the median of the market, while providing opportunity for top quartile compensation for performance above target and below median compensation for performance below target. Additionally, performance goals are set with consideration for historical peer group growth levels, with the goal of ensuring that above target payouts require performance above the median of the peer group.

The target compensation mix for NEOs is substantially weighted towards performance-oriented programs that only deliver value if the Company meets pre-determined performance goals. The Annual Incentive Plan focuses NEOs on achievement of the financial plan for the year. The long-term incentive plan provides alignment with shareholders and focuses NEOs on long-term growth in revenue and NOP as well as return on invested capital. For the CEO and Other NEOs respectively, 79% and 63% of target compensation is weighted towards these performance-oriented programs (i.e., only 21% and 37% of target compensation is delivered in salary for CEO and Other NEOs respectively).





Base Salary. Base salary for executive officers is a fixed compensation component that is reviewed annually and adjusted as appropriate. When making base salary decisions, the Committee considers the external market data as well as a variety of internal criteria, including:

- the scope and complexity of each officer's responsibilities;
- each executive officer's qualifications, skills and experience;
- internal pay equity among senior executives; and
- individual job performance, including both impact on current financial results and contributions to building longer-term competitive advantage and shareholder value.

No specific formula or weight is applied to the various criteria considered.

The Committee also considered the following factors when making the salary adjustments for 2017 that are noted in the table below:

- Under the current leadership, the company has established a consumer innovation strategy and transformed the business with significant investments to strengthen competitive advantages in support of its long-term strategy.
- Ms. Ibach's, Mr. Callen's, and Mr. Carlin's salaries were below the median of the market, and therefore the Committee increased their salaries by 4% to 8% to align more closely with competitive benchmarks.
- The salaries for Ms. Bloomquist and Mr. Krishna were increased by 3.5% in 2017.

($000s)

Name	Title	Salary		
		2016	2017	% Increase
Shelly R. Ibach	President and CEO	$815	$850	4.3%
David R. Callen	SVP and CFO	$404	$436	8.0%
Andrew P. Carlin	EVP, Chief Sales and Services Officer	$426	$460	8.0%
Andrea L. Bloomquist	SVP, Chief Product Officer	$406	$420	3.5%
Suresh Krishna	SVP, Chief Operations, Supply Chain, and Lean Officer	$390	$404	3.5%

Salaries above are represented at the annual rates effective March 27, 2016 and March 26, 2017. These values are different from the Summary Compensation Table, which represents actual salary earned in each year.

Annual Cash Incentive Compensation. Consistent with the company's performance-based compensation philosophy, the opportunity to earn an annual cash incentive is designed to motivate performance at or above the company's targeted annual financial objectives. Achievement of these results delivers compensation near the market median. Total compensation can exceed the median for above-target performance or fall below median for below-target performance. The annual cash incentive program is awarded to motivate and reward performance of a large portion of the company's team member population, including NEOs.

Each fiscal year, the Committee manages three principal elements of the annual cash incentive plan, including:

- Performance Goals. The Committee determines both the type and the specific targets of the performance goals for each fiscal year, selecting metrics that drive both growth and profitability. For 2017, the Committee again selected Adjusted EBITDA as the profit performance metric for the Annual Incentive Plan, reflecting the Committee's commitment to align annual incentive compensation with the company's operating performance and cash generation. The Committee's selection of this profit performance metric for the Annual Incentive Plan also distinguishes it from the Long-Term Incentive Plan performance metrics, which include revenue growth, NOP growth and ROIC.

  In order to support focus on near-term, critical business objectives, cash incentive payments were based in part on semi-annual performance versus targets derived from the annual operating plan, with the opportunity to realize up to 50 percent of pro-rated target cash incentive levels for achievement of semi-annual performance objectives for the first half of the year. To support a strong continuing incentive, if the semi-annual target was not achieved, the opportunity remained to earn the full-year bonus if the full-year target was achieved.

  The Adjusted EBITDA target is approved by the Committee with consideration for performance *after* taking into account all annual cash incentive payments.

- Target and Actual Incentive Levels. For 2017, Ms. Ibach's target incentive level was increased from 100 percent of base salary (unchanged since 2013) to 115 percent of base salary to align more closely with the median of the market. Target incentive levels were maintained at 60 percent for Executive Vice Presidents and 55 percent for Senior Vice

Presidents. These target incentive levels are reviewed annually in comparison with the peer group and general industry market data identified above.

The table below provides detail for the 2017 target incentive and target total cash compensation levels for NEOs, as well as consideration for actual cash compensation with the 121% of target payout for 2017 performance. Both outcomes are consistent with our compensation payout philosophy, which is to pay close to the median of the market for target performance, and close to 25th percentile for performance that is close to threshold. With the 2017 payout of 121% of target, cash compensation (base and annual incentive) was close to the median of the market.

($000s)

Name	Title	2017 Annual Target Cash Compensation			2017 Actual Total Cash*	
		Annual Incentive Target		Target Total Cash	Annual Incentive $	Actual Total Cash
		% of Salary	$			
Shelly R. Ibach	President and CEO	100% / 115%	$940	$1,790	$1,137	$1,987
David R. Callen	SVP and CFO	55%	$236	$672	$285	$721
Andrew P. Carlin	EVP, Chief Sales and Services Officer	60%	$271	$731	$328	$788
Andrea L. Bloomquist	SVP, Chief Product Officer	55%	$229	$649	$277	$697
Suresh Krishna	SVP, Chief Operations, Supply Chain, and Lean Officer	55%	$220	$624	$267	$670

* Cash compensation numbers above represent annualized salary for both target and actual. These values may differ from the Summary Compensation Table, which represents actual salary earned for the year. Shelly Ibach's target bonus % increased from 100% of salary to 115% of salary on March 26, 2017, and this higher target bonus % applied to earnings after this date.

- <u>Leverage Curve of the Annual Cash Incentive Payout</u>. The Committee seeks to set the leverage curve of the annual cash incentive payout, or the percentage of incremental Adjusted EBITDA that is used to fund the overall annual incentive pool, in a manner that both provides a strong motivation for achievement of stretch performance objectives and a reasonable sharing rate of incremental Adjusted EBITDA. Our plan provides for up to 250 percent of target payout opportunity for maximum Adjusted EBITDA performance, and no payout if threshold levels of Adjusted EBITDA are not achieved.

  For the first half of 2017, Adjusted EBITDA (before incentive payout) of $80.6 million exceeded our semi-annual target of $80.0 million, and we therefore paid 50% of the prorated target opportunity for the first half of the year. The table below provides the details for this payout for each NEO ($000s):

Full Name	Position Name	First Half Eligible Earnings	Target AIP %	First Half Target AIP $	Actual Payout: 50% of First Half Target $
Shelly R. Ibach*	President and CEO	$417	100% / 115%	$451	$226
David R. Callen	SVP and CFO	$210	55%	$116	$58
Andrew P. Carlin	EVP, Chief Sales and Service Officer	$222	60%	$133	$67
Andrea L. Bloomquist	SVP, Chief Product Officer	$207	55%	$114	$57
Suresh Krishna	SVP, Chief Operations, Supply Chain, and Lean Officer	$199	55%	$109	$55

* On March 26, 2017, Shelly Ibach's target AIP increased from 100% of salary to 115% of salary for eligible earnings for the remainder of the fiscal year.

For the full-year 2017, our actual Adjusted EBITDA of $169 million (after deduction of annual incentive expense) was above our target of $158 million and below our maximum of

$210 million. This performance above target resulted in a total Annual Incentive payout of 121% of target (inclusive of the mid-year progress payment referenced above). The table below provides more detail for the performance goals used to determine this result ($ millions):

	Payout	Adjusted EBITDA After Annual Incentive Payout	
		$	% Growth
Threshold	20%	$130	-11%
Target	100%	$158	8%
Actual Performance	**121%**	**$169**	**16%**
Maximum	250%	$210	44%

The table below reflects the total Annual Incentive Payout for the full year at 121% of target as well as the incremental payments made at year-end, in addition to the mid-year payouts ($000s).

Full Name	Position Name	Target AIP %	Full Year Target AIP $	Full-Year Actual Payout at 121% of Target	End of Year Payout (Net of Mid-Year)
Shelly R. Ibach*	President and CEO	100% / 115%	$940	$1,137	$912
David R. Callen	SVP and CFO	55%	$236	$285	$227
Andrew P. Carlin	EVP, Chief Sales and Service Officer	60%	$271	$328	$261
Andrea L. Bloomquist	SVP, Chief Product Officer	55%	$229	$277	$220
Suresh Krishna	SVP, Chief Operations, Supply Chain, and Lean Officer	55%	$220	$267	$212

* On March 26, 2017, Shelly Ibach's target AIP increased from 100% of salary to 115% of salary for eligible earnings for the remainder of the fiscal year.

Long-Term Equity-Based Incentive Compensation. The company makes long-term, equity-based incentive compensation grants to its executive officers and other team members to align their interests with those of our shareholders, as well as to provide total compensation that is competitive in the marketplaces in which the company competes for top talent. The Committee seeks to grant equity awards designed to provide total direct compensation that is near the market median, with the potential for greater earnings when the company outperforms its long-term performance targets and the potential for lower earnings in the event the company underperforms its performance targets. As the company offers no pension plan, this equity-based pay component is an important enabler of retirement security for executives and other team members who have dedicated a significant portion of their working careers to our business.

Executive officers and other key team members are eligible for equity-based grants upon joining the company and thereafter on an annual basis. In determining the economic value of equity awards to be granted to executive officers, the Committee considers primarily the competitive position of each executive officer's targeted total direct compensation, including the current value of proposed equity awards, in relation to market data. The Committee also considers a variety of other factors, including:

- company's recent performance relative to the peer group,
- individual performance, including levels of responsibility, and the individual's impact on current results and our long-term competitive position,

- prior awards, including the number of shares awarded and the accumulated "holding power" of unvested equity to motivate both performance and retention, and

- the dilutive impact of equity awards in relation to market data.

The company has historically granted both (i) stock option awards with an exercise price equal to the fair market value on the date of grant, typically vesting ratably over a period of years, and (ii) "performance shares" subject to adjustment based on actual performance versus targets established at the date of grant. The only exceptions have been for new hires and promotions, both of whom typically receive a special award of restricted stock units that vest for continued service over a period of three years. These awards encourage retention and shareholder alignment, as well as provide an up-front equity stake upon hire for new executives.

For the 2017 long-term incentive program, the Committee continued to grant 75% of the annual award value in performance-vested RSUs, with the remaining 25% in stock options. See "Grant of Plan-Based Awards" table below. These grants were approved by the Committee in March 2017.

- Grant value for Ms. Ibach increased slightly (4.8%, from \$2.1 million to \$2.2 million) to align with the median of the market.

- Annual LTI grant value increased by 50% (from \$400k to \$600k) for Mr. Carlin to recognize his new role as EVP, Chief Sales and Services Officer (i.e., his previous annual LTI grants represented awards at the SVP level).

- Annual LTI grant value for Mr. Callen and Ms. Bloomquist increased 18.8% (from \$400k to \$475k) to align more closely with the median of the market.

Total direct compensation for NEOs was aligned with the median of the market. The table below provides detail for total grant value of long-term incentives (LTI) awarded in 2016 and 2017, as well as the resulting 2017 Target total direct compensation (sum of base salary, value of target annual incentive opportunity and the grant value of LTI).

(\$000s)

Name	Title	LTI Target Grant Value (Annual Award)			
		2016	2017	% +/-	2017 Target TDC
Shelly R. Ibach	President and CEO	\$2,100	\$2,200	4.8%	\$3,990
David R. Callen	SVP and CFO	\$400	\$475	18.8%	\$1,147
Andrew P. Carlin	EVP, Chief Sales and Services Officer	\$400	\$600	50.0%	\$1,331
Andrea L. Bloomquist	SVP, Chief Product Officer	\$400	\$475	18.8%	\$1,124
Suresh Krishna	SVP, Chief Operations, Supply Chain, and Lean Officer	\$500	\$475	-5.0%	\$1,099

LTI grant values are converted to a number of shares using a 20-day average stock price leading up to date of grant in order to mitigate short-term stock price volatility. As such, values in the table above are different from the grant date fair values in the Summary Compensation Table.

Performance-vested RSU payouts and grants.

2015 Performance-Vested RSUs: The performance-vested units granted in 2015 were earned at 86% of target, based on annual growth in revenue and NOP during each of 2015 – 2017, as well as the three-year average for each measure. The shares earned are vested in full on the third anniversary of the grant date (March 16, 2018). Revenue (or net sales) and NOP (or operating income) are both GAAP measures as reported in the company's Annual Report on Form 10-K.

This plan is a full three-year performance plan. There is no payout, if any, until the end of the three-year period and the percentage growth goals (e.g. "performance levels") are determined at the beginning of the performance period and are not changed. The performance levels indicated below are applied to each prior year actual revenue and NOP outcome to develop the goals for each year of the three-year performance period. Annual growth in both revenue and NOP is measured to determine a total of six performance scores over the three-year period (i.e., three scores for revenue growth and three scores for NOP growth; revenue and NOP growth are equally weighted).

Performance Level	Payout	Revenue	NOP
Below Threshold	0%	<4%	<4%
Threshold	50%	4%	4%
Target	100%	7%	9%
Max	200%	15%	20%

The three revenue scores are averaged to determine the revenue payout for the three-year period, and the three NOP scores are averaged to determine the NOP payout for the three-year period. The table below provides detail for the performance results used to determine the 86% of target payout for the 2015 – 2017 performance period. The payout was positively impacted by strong revenue growth well-above peer group median levels, and negatively impacted by NOP performance in 2015 and 2016 largely related to the impact of ERP implementation and strategic investments made to support our long-term strategy.

Year	Revenue (Net Sales) - GAAP			NOP - Excluding ERP Launch Cost*		
	$	Growth	Perf Score	$	Growth	Perf Score
2014	$1,157			$102		
2015	$1,214	4.9%	**65%**	$87	-14.8%	**0%**
2016	$1,311	8.0%	**113%**	$77	-11.5%	**0%**
2017	$1,444	10.2%	**139%**	$92	19.9%	**199%**
Average			**106%**			**66%**
Weighting			**50%**			**50%**

Total Payout % of Target	**86.2%**

*NOP excludes 2015 ERP Launch Costs of $11.6 million (i.e., one-time, non-recurring expenses for system training).

The Committee also added an ROIC objective to the program in 2015 to ensure that payouts are reduced if returns are not sufficiently above the company's WACC. If three-year average ROIC does not exceed WACC by at least 30%, then the final payout will be reduced by a minimum of 5% and a maximum of 20% of the target number of units.

For the 2015 – 2017 performance period, ROIC exceeded WACC by more than 30%. (see table below for more details):

	2015	2016	2017
Return On Invested Capital (ROIC)	11.2%	12.2%	14.3%
Weighted Average Cost of Capital (WACC)	9.6%	7.9%	7.7%
Return Premium (ROIC % +/- WACC)	**16.7%**	**54.4%**	**85.7%**

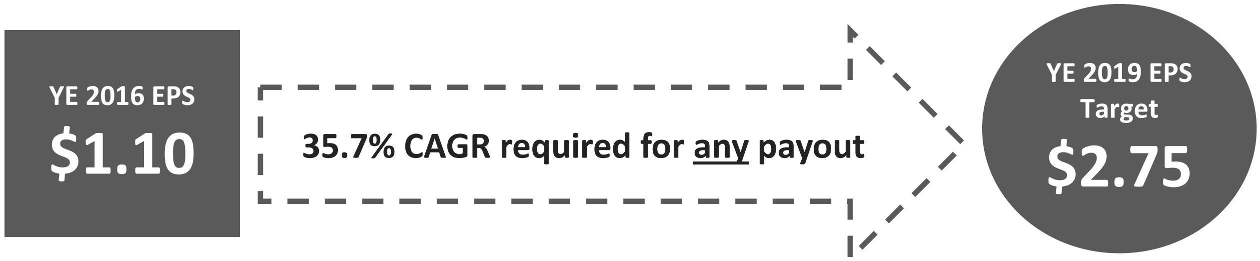
3-Year Avg.	**52.3%**

The Committee uses ROIC in the LTI program because it ensures that we are investing capital efficiently to generate both net sales growth and NOP growth over the long-term, thus aligning the company's and shareholders' interests. As financial stewards of the company's assets, both Management and the Board are committed to deploying capital efficiently to generate superior returns for shareholders.

<u>2017 Performance-Vested RSUs</u>: The performance-vested units granted in 2017 follow a similar structure as the 2015 awards described above. Performance units will be earned based on annual growth in Revenue and NOP, equally weighted, through 2019, and will vest in March 2020 depending on performance achievement. Performance below the defined threshold would result in a payout of zero. The maximum payout is 200 percent of the target number of units granted. The payouts will also be subject to reduction for failure to generate ROIC that sufficiently exceeds WACC.

<u>2017 Special Performance-Vested RSU Awards</u>:

In March 2017, NEOs received special performance-vested RSUs that will only be earned if our diluted net income per share for the fiscal year ending December 28, 2019 is at or above $2.75 (the "EPS Target") (note: tax rate for EPS calculation is held constant at the 2016 rate of 32.3% which was the most current full-year tax rate at the date of this grant; no subsequent tax rate changes will be included in the EPS calculation for the purpose of determining if this award is earned*). The Committee granted these awards to create alignment with the long-term goal we have communicated to shareholders, and to ensure that we are appropriately rewarding our senior leaders for achievement of the aggressive long-term plan to achieve EPS of $2.75 by 2019.



Achievement of the EPS Target requires a total increase of 150% and a three-year Compound Annual Growth Rate (CAGR) of 35.7% from the 2016 EPS of $1.10, and this level of growth would represent performance at or above the historical top decile of the benchmarks for the peer group. These awards reinforce our commitment to our pay for performance philosophy.

The performance-based restriction on the awards will lapse on March 21, 2020, the third anniversary of the grant date, if the EPS Target is achieved, in which case 50% of the units subject to the awards would vest and be issued following March 21, 2020. And, if the EPS Target is achieved, the remaining 50% of the units subject to the awards would vest and be issued following March 21, 2021, the fourth anniversary of the grant date. The vesting of the awards is conditioned upon the recipient's continued employment or service to the company through the applicable vesting dates, subject to certain exceptions. Vested award units will be settled in shares of our common stock on a one-for-one basis. The Committee will determine whether the EPS Target is achieved based on our audited financial statements for the fiscal year ended December 28, 2019. The total number of units subject to each award would be reduced by 15% if the company's TSR does not increase during the period beginning on the date of grant and ending on December 28, 2019.

The table below provides details for the grant value and number of performance-vested RSUs granted in connection with these special awards:

($000s)

Name	Title	Award Grant Value**	# of RSUs
Shelly R. Ibach	President and CEO	$3,131	138,595
David R. Callen	SVP and CFO	$332	14,700
Andrew P. Carlin	EVP, Chief Sales and Services Officer	$332	14,700
Andrea L. Bloomquist	SVP, Chief Product Officer	$332	14,700
Suresh Krishna	SVP, Chief Operations, Supply Chain, and Lean Officer	$332	14,700

* The $2.75 goal referenced above is calculated using the 2016 tax rate of 32.3%, and the 2019 actual tax rate inclusive of benefit from tax reform is currently expected to be lower. If the 2019 actual tax rate is in fact lower than 32.3%, then holding the tax rate constant at the 2016 rate of 32.3% makes the goal more difficult to achieve.

**Monte Carlo valuation of 94.88% of face value. Based on 20-day avg stock price of $23.81.

(LTI grant values are converted to a number of shares using a 20-day average stock price leading up to date of grant in order to mitigate short-term stock price volatility. As such, the value referenced above are different from the grant date fair values in the Summary Compensation Table.)

The Summary Compensation Table includes the full grant value of these special awards in 2017 compensation. The table below illustrates how this disclosure would appear for 2017 compensation without the grant value of the special award:

Name And Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards (Excluding Special Performance Award) ($)	Option Awards ($)	Non-Equity Incentive Plan Compensa-tion ($)	All Other Compensa-tio ($)	Total ($)
Shelly R. Ibach President and CEO	2017	$841,923	---	$1,636,173	$540,042	$ 1,137,400	$ 30,363	$4,185,901
David R. Callen SVP and CFO	2017	$428,431	---	$ 353,206	$ 116,614	$ 285,120	$ 10,802	$1,194,173
Andrew P. Carlin EVP, Chief Sales and Services Officer	2017	$451,791	---	$ 446,229	$ 147,275	$ 328,000	$ 11,050	$1,384,345
Andrea L. Bloomquist SVP and Chief Product Officer	2017	$416,520	---	$ 353,206	$ 116,614	$ 277,194	$ 10,054	$ 1,173,588
Suresh Krishna SVP and Chief Operations, Supply Chain and Lean Officer	2017	$400,500	---	$ 353,206	$ 116,614	$ 266,533	$ 11,802	$1,148,655

Severance Compensation. In February of 2007, the Board adopted the Sleep Number Corporation Executive Severance Pay Plan (the "Severance Plan") to establish consistent severance benefits for senior executives upon termination of their employment by the company without cause or upon resignation for "good reason" as defined by the Severance Plan. Prior to the adoption of the Severance Plan some, but not all, of our senior executives were entitled to severance benefits pursuant to their employment offer letters. The Severance Plan provides more uniform benefits across the senior management team, including NEOs and others. No executive officer would be entitled to any severance compensation in excess of the benefits provided under the company's Severance Plan. In June of 2017, the Committee approved an amended and restated version of the Severance Plan. The prior version of the Severance Plan provided for, and the amended and restated Severance Plan maintains, the base severance pay for our CEO and other NEOs for a termination without "cause" or upon resignation for "good reason," each as defined in the Severance Plan, as follows:

- for the CEO: (i) two times the sum of annual base salary and annual target cash incentive plus (ii) a pro rata portion of the executive's annual cash incentive; and
- for the other NEOs, (i) one times the sum of annual base salary and annual target cash incentive plus (ii) a pro rata portion of the executive's annual cash incentive.

Under the prior version of the Severance Plan, the pro rata cash incentive payment was based on the executive's target cash incentive for the year of termination. Under the amended and restated version of the Severance Plan, the pro rata cash incentive payment is based on the average annual cash incentive actually received by the executive during the three most recent fiscal years prior to the year of termination.

Under the prior version of the Severance Plan, the base severance amounts described above were not increased if the termination of employment without cause or resignation for good reason was in connection with a change in control of the company. The amended and restated Severance Plan provides an additional change in control severance pay amount for the CEO and other NEOs for a termination of employment without cause or resignation for good reason within six months before (or, if later, the date on which discussions with a third party regarding the change in control began) or 24 months after a change in control of the company, and subject to additional non-competition and non-solicitation requirements, equal to one times the sum of annual base salary and annual target cash incentive.

The changes to the Severance Plan align more closely with the market median, and also allow us to extend our non-compete and non-solicitation period from one year to two years for NEOs who receive the higher change in control payment under the Severance Plan (i.e., the extra year of compensation in connection with a change in control referenced above is connected to an extra year of non-compete and non-solicitation). In addition, we made the changes outlined below:

- Updated various plan provisions to ensure compliance with both 409A and 162(m).
- Edited various plan provisions to provide more clarity for the Change in Control protection period and how 280G calculations are administered.

In developing the Severance Plan and determining the benefits payable under the Severance Plan, the Committee considered market data received from its independent compensation consultant relative to typical severance benefits and concluded that the benefits payable under the Severance Plan were generally at or below the market data.

Benefits under the Severance Plan are conditioned upon execution and delivery to the company of a general release of claims and return of any company property. In addition, in the event the signed general release of claims is subsequently declared invalid or is revoked or attempted to be revoked, or in the event of a violation by the former executive of a non-compete or confidentiality agreement with the company, any unpaid severance compensation would be terminated. Each NEO has signed a non-compete agreement extending for one year following termination of employment and a confidentiality agreement of indefinite duration. For any NEO to receive the severance payments referenced above, the NEO would need to sign a two-year non-compete agreement.

The base severance compensation would be paid in a lump sum within a reasonable time following the team member's termination of employment and in no event later than March 1 of the year following the year during which the termination occurs. None of the amounts payable under the Severance Plan are subject to any "gross-up" for tax purposes in the event of the applicability of any excise or similar taxes.

In addition to the base severance compensation described above, the Severance Plan provides for reimbursement of the cost of "COBRA" medical and dental "COBRA" continuation coverage, less the amount paid by an active full-time team member for the same level of coverage, until the earlier of:

- the end of the period of time reflected in the base severance compensation (i.e., two years for CEO and one year for the other NEOs);
- the end of the participant's eligibility for COBRA continuation coverage; or
- the date the participant becomes eligible to participate in another group medical plan or dental plan.

The Severance Plan also provides for outplacement services in an amount up to $15,000 for the CEO and up to $10,000 for other senior executives.

No severance payment would be triggered solely by a change in control of the company. The Severance Plan does provide, however, that during a 24-month period following a change in control of the company, the company may not terminate the Severance Plan and may not reduce the severance benefits payable to participants who are employed by the company immediately prior to the change in control. For additional information, see "Potential Payments to Named Executive Officers," below.

Non-Qualified Deferred Compensation Plan. As described in more detail on page 59 of this Proxy Statement, certain executive team members (for example, director level and above) may defer a portion of their compensation and defer payment of restricted stock unit awards under a non-qualified deferred compensation plan that offers a range of investment options similar to those available under our 401(k) plan. The company may also make discretionary employer credits to this plan although it has not elected to do so.

Benefits and Perquisites. Our executive officers generally receive the same menu of benefits offered to other full-time team members including, but not limited to, our 401(k) plan. After completing an eligibility service period, our team members who have attained age 21 are eligible to participate in our 401(k) plan. The 401(k) plan includes company stock as an investment option, providing another opportunity for our senior executives and other team members to build stock ownership in our company. The company has historically made discretionary matching contributions (at various levels) of a portion of team members' contributions to the 401(k) plan.

As the company provides no defined benefit pension plan, we believe the 401(k) plan and the non-qualified deferred compensation plan are important elements in retirement planning for executives and other eligible team members.

We generally avoid special executive perquisites. We do offer two executive benefits to senior management that are designed to address specific corporate purposes:

- Annual Physical Exam. Members of our senior management team are encouraged to annually undergo a comprehensive physical examination. The company offers several executive physical options, which generally range in cost from $2,300 to $4,000. These costs, after insurance coverage, are paid by the company and constitute taxable wages to the executive that are not "grossed up" for tax purposes. This benefit is designed to promote preventive care, enhance the health and wellness of senior management and to catch potential health issues at an early stage.

- Tax and Financial Planning. Members of our senior management team are eligible for reimbursement of expenses for tax and financial planning services up to $15,000 per year for the CEO and up to $8,000 per year for executive or senior vice presidents. Amounts reimbursed under this benefit represent taxable wages that are not "grossed up" for tax purposes. This benefit is designed to enhance financial planning, to avoid distraction of members of the senior management team and to promote tax compliance.

Chief Executive Officer Compensation and Performance

The compensation for Shelly R. Ibach, our President and Chief Executive Officer, consists of an annual base salary, annual cash incentive compensation and long-term equity-based incentive compensation. The Committee determines the level for each of these compensation elements using methods consistent with those used for the company's other senior executives, including the assessment of individual performance and review of competitive data. The Committee evaluates Ms. Ibach's performance by soliciting input from all members of the Board as well as members of the senior management team. The Board also assesses Ms. Ibach's performance against objectives incorporating key operational and strategic factors, including growth, profitability, product innovation, advancement of strategic initiatives, organizational development and investor relations. The CEO performance feedback from all independent Board members is consolidated into a detailed performance review which is the basis of a full Board discussion in Executive Session led by the Chair of the Committee. The Board's assessment of Ms. Ibach's performance is a major consideration in determining any compensation adjustments for the coming year.

Tax and Accounting Implications

Deductibility of Executive Compensation.
In designing performance awards under our equity-based incentive plan and our annual cash bonus plan, we consider the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code, which generally provides that we may not deduct more than $1 million paid to certain executive officers, other than for "performance-based" compensation meeting certain requirements. The Tax Cut and Jobs Act, signed into law on December 22, 2017 (the "Tax Act"), among other things, repealed the exemption from the Section 162(m) limit for "performance-based" compensation effective for the Company's taxable years beginning after December 31, 2017, subject to transition relief for binding contracts entered into prior to November 2, 2017. Our equity-based incentive plan and our annual cash bonus plan are designed to permit the grant and payment of equity or cash incentive awards that qualify as "performance-based" compensation, which, to the extent applicable, would be exempt from the Section 162(m) deduction limitation. While these plans are designed to be operated in a manner intended to exempt the payments from the Section 162(m) deduction limitation, the Committee may administer the plans in a manner that does not satisfy the requirements to achieve a result that the Committee determines to be appropriate. Despite the Committee's efforts to structure performance-based compensation in a manner intended to be exempt from the 162(m) limit,

because of the Tax Act repeal of the performance-based pay exception, and the ambiguities and uncertainties as to the application and interpretation of Section 162(m) as revised by the Tax Act, including the uncertain scope of the transition relief contained in the Tax Act, no assurance can be given that compensation intended to satisfy the requirements for an exemption from the Section 162(m) deduction limit in fact will be exempt.

Despite the changes to Section 162(m) as a result of the Tax Act and consistent with our executive compensation philosophy of linking pay to performance and aligning executive interests with those of our shareholders, we currently expect that we will continue to structure our executive compensation program so that a significant portion of total executive compensation is linked to the performance of our Company.

Summary Compensation Table

The following table summarizes the total compensation paid or earned by each of the named executive officers for the 2017 fiscal year ended December 30, 2017 (and for the 2016 and 2015 fiscal years if the individual was a named executive officer in those years, respectively). The details of our named executive officers' compensation are discussed in the Compensation Discussion and Analysis beginning on page 28.

Name And Principal Position	Year	Salary ($)	Bonus[6] ($)	Stock Awards[1][2] ($)	Option Awards[1][3] ($)	Non-Equity Incentive Plan Compensation[4][6] ($)	All Other Compensation[5] ($)	Total ($)
Shelly R. Ibach President and CEO	2017	$841,923	---	$4,740,701	$540,042	$ 1,137,400	$ 30,363	$7,290,429
	2016	$814,615	---	$1,597,928	$493,284	$ 354,998	$ 23,205	$3,284,030
	2015	$779,231	---	$1,561,875	$484,356	$ 188,462	$ 12,700	$3,026,624
David R. Callen SVP and CFO	2017	$428,431	---	$ 682,486	$ 116,614	$ 285,120	$ 10,802	$ 1,523,453
	2016	$400,637	---	$ 304,346	$ 93,979	$ 96,034	$ 9,327	$ 904,323
	2015	$383,618	---	$ 234,240	$ 72,621	$ 52,257	$ 8,570	$ 751,306
Andrew P. Carlin EVP, Chief Sales and Services Officer	2017	$451,791	---	$ 775,509	$ 147,275	$ 328,000	$ 11,050	$1,713,625
	2016	$415,369	---	$ 670,240	$ 93,979	$ 106,385	$ 8,025	$1,293,998
	2015	$354,728	---	$ 312,375	$ 96,855	$ 46,156	$ 7,950	$ 818,064
Andrea L. Bloomquist SVP and Chief Product Officer	2017	$416,520	---	$ 682,486	$ 116,614	$ 277,194	$ 10,054	$ 1,502,868
	2016	$403,500	---	$ 304,346	$ 93,979	$ 96,718	$ 11,960	$ 910,503
	2015	$355,915	---	$ 312,375	$ 96,855	$ 45,563	$ 7,950	$ 818,658
Suresh Krishna SVP and Chief Operations, Supply Chain and Lean Officer	2017	$400,500	---	$ 682,486	$ 116,614	$ 266,533	$ 11,802	$1,477,935
	2016	$285,000	$144,127	$1,059,989	$437,402	$ 70,373	$ 17,095	$2,013,986

(1) Reflects the aggregate grant date fair value of stock and option awards granted during fiscal years 2017, 2016 and 2015, computed in accordance with FASB ASC Topic 718. See Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017, for a discussion of the relevant assumptions used in calculating these amounts.

(2) The "Stock Awards" column includes performance stock awards. The amounts included for the performance stock awards represent the grant date fair value assuming the achievement of the target performance award level. The following table presents the grant date fair value of the performance stock awards included in the "Stock Awards" column and the maximum grant date fair value of these awards assuming that the highest level of performance conditions would be achieved. For further information on these awards, see the Grants of Plan-Based Awards table.

	2017		2016		2015	
	Grant Date Fair Value	**Maximum Value**	**Grant Date Fair Value**	**Maximum Value**	**Grant Date Fair Value**	**Maximum Value**
Ms. Ibach	$4,740,701	$6,376,874	$1,597,928	$3,195,857	$1,561,875	$3,123,750
Mr. Callen	$ 682,486	$1,035,692	$ 304,346	$ 608,692	$ 234,240	$ 468,480
Mr. Carlin	$ 775,509	$1,221,738	$ 304,346	$ 608,692	$ 312,375	$ 624,750
Ms. Bloomquist	$ 682,486	$1,035,692	$ 304,346	$ 608,692	$ 312,375	$ 624,750
Mr. Krishna	$ 682,486	$1,035,692	$ 407,658	$ 815,317	$ ---	$ ---

(3) The "Option Awards" column includes a market-based option award in 2016 for Mr. Krishna. The associated $312,625 grant date fair value included in the "Option Awards" column is also the maximum value of the award assuming that the market condition would be achieved. The market condition requires the company's closing stock price to exceed $27.00 for 20 consecutive trading days and can be achieved any time prior to April 11, 2026, subject to continuing employment.

(4) Represents annual incentive compensation earned under the AIP. See discussion in the Compensation Discussion and Analysis under the heading "Annual Cash Incentive Compensation."

(5) All other compensation includes the costs of (i) reimbursement for personal financial planning and tax advice; (ii) company sponsored physical exam; (iii) company contribution to the executive's 401(k) account; and (iv) reimbursement of personal travel expenses for Ms. Ibach which was intended to allow Ms. Ibach to conduct company work remotely while travelling.

(6) For 2016, Mr. Krishna was guaranteed a minimum payment equal to the target incentive level under the AIP. The amount in the Non-Equity Incentive Plan Compensation column reflects the amount that would have been earned under the plan if there had been no guarantee. The amount in the Bonus column reflects the difference between the guaranteed minimum payment and the amounts that would have been earned under the plan if there had been no guarantee.

Grants of Plan-Based Awards

The following table summarizes grants of equity and non-equity plan-based awards to each of the named executive officers during the 2017 fiscal year ended December 30, 2017.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards[1] Threshold ($)	Target ($)	Maximum ($)	Estimated Future Payouts Under Equity Incentive Plan Awards Threshold (#)	Target (#)	Maximum (#)	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)[5]
Shelly R. Ibach		$188,000	$940,000	$2,350,000							
	3/21/17[2]				5,775	69,300	138,600				$1,636,173
	3/21/17[3]				110,876	138,595	138,595				$3,104,528
	3/21/17[4]								53,720	$23.61	$ 540,042
David R. Callen		$ 47,127	$235,637	$ 589,092							
	3/21/17[2]				1,247	14,960	29,920				$ 353,206
	3/21/17[3]				11,760	14,700	14,700				$ 329,280
	3/21/17[4]								11,600	$23.61	$ 116,614
Andrew P. Carlin		$ 54,215	$271,074	$ 677,686							
	3/21/17[2]				1,575	18,900	37,800				$ 446,229
	3/21/17[3]				11,760	14,700	14,700				$ 329,280
	3/21/17[4]								14,650	$23.61	$ 147,275
Andrea L. Bloomquist		$ 45,817	$229,086	$ 572,715							
	3/21/17[2]				1,247	14,960	29,920				$ 353,206
	3/21/17[3]				11,760	14,700	14,700				$ 329,280
	3/21/17[4]								11,600	$23.61	$ 116,614
Suresh Krishna		$ 44,055	$220,275	$ 550,688							
	3/21/17[2]				1,247	14,960	29,920				$ 353,206
	3/21/17[3]				11,760	14,700	14,700				$ 329,280
	3/21/17[4]								11,600	$23.61	$ 116,614

(1) This represents the cash incentive opportunity for 2017 under the AIP. The actual amounts earned under this plan for 2017 are reported in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table. The threshold reflects the amount that would be payable under the plan if the minimum performance level is achieved for annual company-wide performance goals. If the minimum performance level for payment of the threshold amount is not achieved, then no annual incentive would be payable under the plan. Grantees had the opportunity to realize up to 50 percent of pro-rated target incentive levels for achievement of semi-annual performance objectives for the first half of the year. See discussion in the Compensation Discussion and Analysis under the heading "Annual Cash Incentive Compensation."

(2) These awards represent performance stock unit awards described in greater detail in the Compensation Discussion and Analysis under the heading, "Long-Term Equity-Based Incentive Compensation." The target number of units may be adjusted based on company performance during the performance period which ends December 28, 2019 (fiscal 2019 year-end). The adjusted amount of the award then fully vests after three years from the grant date. If any dividends are paid on our common stock, the holders of the performance stock units awards would receive dividends at the same rate as paid to other shareholders if and when the performance stock unit award becomes fully vested.

(3) These awards represent performance stock unit awards with a market condition described in greater detail in the Compensation Discussion and Analysis under the heading, "Special Performance-Vested RSU Awards." The awards vest 50% three years from the grant date and 50% four years from the grant date, subject to continued employment and achievement of the performance criterion. The performance criterion requires earnings per share of $2.75 for the year ending December 28,

2019 (fiscal 2019). If the performance criterion is not achieved, no units will be earned, except that if the performance criterion would have been achieved if a portion of the stock-based compensation expense attributable to the awards had been excluded from the calculation of earnings per share, then the target number of units may be adjusted downward, until earnings per share equals $2.75 on a pro forma basis. However, if this pro forma adjustment would require more than a 20% reduction in the target number of units, no units will be earned. In addition, the target number of units may be adjusted downward by 15% if the Company's total shareholder return from the date of grant through December 28, 2019 is negative.

(4) These awards represent stock options described in greater detail in the Compensation Discussion and Analysis under the heading, "Long-Term Equity-Based Incentive Compensation." These stock options have an exercise price equal to the closing trading price of the company's common stock on the grant date. The options become exercisable in installments of one-third of the options awarded on each of the first three anniversaries of the grant date. These options remain exercisable for up to 10 years from the grant date, subject to earlier termination upon certain events related to termination of employment.

(5) Reflects the grant date fair value computed in accordance with FASB ASC Topic 718. The value for awards subject to market or performance conditions reflects the target payout.

Outstanding Equity Awards at Fiscal Year-End

The following table summarizes the total outstanding equity awards for each of the named executive officers as of December 30, 2017.

	Option Awards				Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)[13]	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)[13]
Shelly R. Ibach	6,610	---	$ 3.76	3/7/2018	---	---	---	---
	7,500	---	$ 0.79	6/18/2019	---	---	---	---
	27,375	---	$ 9.75	6/4/2020	---	---	---	---
	14,038	---	$17.34	5/11/2021	---	---	---	---
	17,900	---	$28.99	2/23/2022	---	---	---	---
	13,526	---	$25.99	6/1/2022	---	---	---	---
	41,950	---	$21.15	4/1/2023	---	---	---	---
	27,430	---	$17.77	3/28/2024	---	---	---	---
	19,653	9,827[1]	$33.32	3/16/2025	---	---	---	---
	---	---	---	---	40,407[2]	$ 1,518,899	---	---
	19,264	38,526[3]	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	---	---	84,951[4]	$3,193,308
	---	53,720[10]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	69,300[11]	$2,604,987
	---	---	---	---	---	---	138,595[12]	$5,209,786
David R. Callen	7,395	---	$17.36	4/7/2024	---	---	---	---
	2,947	1,473[1]	$33.32	3/16/2025	---	---	---	---
	---	---	---	---	6,060[2]	$ 227,795	---	---
	3,670	7,340[3]	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	---	---	16,180[4]	$ 608,206
	---	11,600[10]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	14,960[11]	$ 562,346
	---	---	---	---	---	---	14,700[12]	$ 552,573
Andrew P. Carlin	9,845	---	$ 9.75	6/4/2020	---	---	---	---
	200	---	$17.34	5/11/2021	---	---	---	---
	3,000	---	$28.99	2/23/2022	---	---	---	---
	4,165	---	$25.99	6/1/2022	---	---	---	---
	11,450	---	$21.15	4/1/2023	---	---	---	---
	9,350	---	$17.77	3/28/2024	---	---	---	---
	3,930	1,965[1]	$33.32	3/16/2025	---	---	---	---
	---	---	---	---	8,082[2]	$ 303,802	---	---
	3,670	7,340[3]	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	---	---	16,180[4]	$ 608,206
	---	---	---	---	18,880[5]	$ 709,699	---	---
	---	14,650[10]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	18,900[11]	$ 710,451
	---	---	---	---	---	---	14,700[12]	$ 552,573

Outstanding Equity Awards at Fiscal Year-End, continued

	Option Awards				Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($) [13]	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($) [13]
Andrea L. Bloomquist	3,000	---	$ 3.07	5/5/2018			---	---
	1,750	---	$ 0.94	6/1/2019	---	---	---	---
	13,125	---	$ 9.75	6/4/2020	---	---	---	---
	3,100	---	$17.34	5/11/2021	---	---	---	---
	3,000	---	$28.99	2/23/2022	---	---	---	---
	3,332	---	$25.99	6/1/2022	---	---	---	---
	11,450	---	$21.15	4/1/2023	---	---	---	---
	9,350	---	$17.77	3/28/2024	---	---	---	---
	3,930	1,965[1]	$33.32	3/16/2025	---	---	---	---
	---	---	---	---	8,082[2]	$ 303,802	---	---
	3,670	7,340[3]	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	---	---	16,180[4]	$ 608,206
	---	11,600[10]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	14,960[11]	$ 562,346
	---	---	---	---	---	---	14,700[12]	$ 552,573
Suresh Krishna	4,770	9,540[6]	$19.38	4/11/2026	---	---	---	---
	---	30,500[7]	$19.38	4/11/2026	---	---	---	---
	---	---	---	---	14,025[8]	$ 527,200	---	---
	---	---	---	---	---	---	21,035[9]	$ 790,706
	---	11,600[10]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	14,960[11]	$ 562,346
	---	---	---	---	---	---	14,700[12]	$ 552,573

(1) These stock options were granted on March 16, 2015 and vest one-third each year on each of the first three anniversaries of the date of grant, subject to continuing employment through the applicable vesting date.

(2) These performance stock units were granted on March 16, 2015 and vest 100% on March 16, 2018, subject to achieving performance criteria and continuing employment through the vesting date. The shares are reflected at actual performance achievement level. The performance period was completed as of fiscal 2017 year end.

(3) These stock options were granted on March 22, 2016 and vest one-third each year on each of the first three anniversaries of the date of grant, subject to continuing employment through the applicable vesting date.

(4) These performance stock units were granted on March 22, 2016 and vest 100% on March 22, 2019, subject to achieving performance criteria and continuing employment through the vesting date. The shares are reflected at the target award level. The performance period continues through fiscal 2018 year end.

(5) These restricted stock units were granted on April 11, 2016 and vest 100% on April 11, 2019, subject to continuing employment through the applicable vesting date.

(6) These stock options were granted on April 11, 2016 and vest one-third each year on each of the first three anniversaries of the date of grant, subject to continuing employment through the applicable vesting date.

(7) These market-based stock options were granted on April 11, 2016 and vest 100% on April 11, 2019, subject to continuing employment through the vesting date; provided, however, that the options will only become exercisable

if the market condition is achieved. The shares are reflected at the target award level, which is the same as the maximum award level. The market condition requires the company's closing stock price to exceed $27.00 for 20 consecutive trading days and can be achieved any time prior to April 11, 2026, subject to continuing employment. As of December 30, 2017, the market condition had been achieved.

(8) These restricted stock units were granted on April 11, 2016 and vest one-half each year on each of the first two anniversaries of the date of grant, subject to continuing employment through the applicable vesting date.

(9) These performance stock units were granted on April 11, 2016 and vest 100% on April 11, 2019, subject to achieving performance criteria and continuing employment through the vesting date. The shares are reflected at the target award level. The performance period continues through fiscal 2018 year end.

(10) These stock options were granted on March 21, 2017 and vest one-third each year on each of the first three anniversaries of the date of grant, subject to continuing employment through the applicable vesting date.

(11) These performance stock units were granted on March 21, 2017 and vest 100% on March 21, 2020, subject to achieving performance criteria and continuing employment through the vesting date. The shares are reflected at the target award level. The performance period continues through fiscal 2019 year end.

(12) These performance stock units were granted on March 21, 2017 and vest 50% on March 21, 2020 and 50% on March 21, 2021, subject to achieving a performance criterion and continuing employment through the vesting date. In addition, the units ultimately earned for achievement of the performance criterion can be reduced by 15% if a market condition is not met. The shares are reflected at the target award level, which is the same as the maximum award level. The performance period continues through fiscal 2019 year end.

(13) Calculated by multiplying unvested shares by $37.59, the closing price of the company's common stock on the Nasdaq Stock Market on December 29, 2017, the last trading day of fiscal 2017.

Option Exercises and Stock Vested

The following table summarizes the stock options exercised and restricted stock awards vested for each of the named executive officers during the fiscal year ended December 30, 2017.

	Option Awards		**Stock Awards**	
Name	**Number of Shares Acquired on Exercise (#)**	**Value Realized on Exercise ($)(1)**	**Number of Shares Acquired on Vesting (#)**	**Value Realized on Vesting ($)(2)**
Shelly R. Ibach	23,700	$ 330,275	76,903	$1,855,669
David R. Callen	---	---	15,387	$ 390,214
Andrew P. Carlin	14,500	$ 433,666	30,448	$ 734,710
Andrea L. Bloomquist	---	---	30,448	$ 734,710
Suresh Krishna	---	---	19,635	$ 495,391

(1) The value realized on the exercise of stock options for purposes of this table is based on the difference between the fair market value of our common stock on the date of exercise and the exercise price of the stock option.

(2) The value realized on the vesting of stock awards for purposes of this table is based on the fair market value of our common stock on the date of vesting of the award.

Nonqualified Deferred Compensation

The following table summarizes the aggregate earnings and balances for each of the named executive officers under the Select Comfort Executive Investment Plan, the company's non-qualified deferred compensation plan (described in greater detail below), for the 2017 fiscal year ended December 30, 2017.

Name	Executive Contributions in Last Fiscal Year ($)	Registrant Contributions in Last Fiscal Year ($)	Aggregate Earnings in Last Fiscal Year ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last Fiscal Year-End[1] ($)
Shelly R. Ibach	$452,338	---	$111,205	---	$ 951,508
David R. Callen	---	---	$ 875	---	$ 38,404
Andrew P. Carlin	$283,503	---	$162,783	---	$1,045,487
Suresh Krishna	---	---	---	---	---
Andrea L. Bloomquist	---	---	---	---	---

(1) Among the named executive officers, Ms. Ibach, Mr. Callen and Mr. Carlin had account balances under the plan as of December 30, 2017. Mr. Krishna and Ms. Bloomquist did not elect to participate in the plan in fiscal year 2017.

As determined by the plan administrator each year, certain executive team members (for example, director level and above) may be eligible to participate in the Sleep Number Executive Investment Plan, a non-qualified deferred compensation plan. Under this plan, eligible team members may defer up to 50% of base salary and up to 75% of bonus compensation on a pre-tax basis. These voluntary team member salary and bonus deferrals are credited to the participant's "savings account." (Elective deferrals made by eligible team members prior to January 1, 2009 could have been credited to a "fixed period account.") No team members were eligible to make deferrals of base salary or bonus during the 2009, 2010 and 2011 plan years and the first six months of the 2012 plan year.

In addition to deferrals made by eligible team members, the company may elect to credit eligible team members with discretionary employer credits to a "retirement account." The company has not elected to make any discretionary employer credits under this plan.

A participant's account under the plan is also credited with earnings credits which are based on deemed investment in a variety of funds made available by the plan administrator and which are currently similar to the investment fund options available under the company's 401(k) plan. The participant selects the funds into which the account balance is deemed to be invested and these allocations may be changed by the participant at any time.

Amounts credited to savings and retirement accounts are paid out no later than 90 days (or six months for executive officers) after the participant's "termination date" (which means the date the participant separates from service as defined under Internal Revenue Code Section 409A). Payment of the fixed period account depends on the date (or dates) of distribution elected by the participant at the time he or she made the election to defer salary or bonus to a fixed period account. Distributions to the participant may be made in a lump sum payment or in annual installment payments. Prior to the termination date (or the fixed payment date of a fixed period account), a participant may be allowed to receive a lump sum distribution from his or her account in the event of certain unforeseeable emergencies. The participant's account (if any) upon his or her date of death is paid in a lump sum to the participant's plan beneficiary or beneficiaries.

Employment Arrangements, Potential Payments upon Change in Control

<u>No Employment Agreements</u>. All Sleep Number team members, including all executive officers, are "at will" team members, meaning that the team member or the company may terminate the employment relationship with or without cause and with or without notice, at any time at the option of either the team member or the company. No executive officer of the company has any contractual or other right to employment for any term or period of time. In addition, no executive officer would be entitled to any severance compensation in excess of the benefits provided under the company's Severance Plan described above.

<u>Change in Control Provisions –2004 Stock Incentive Plans</u>

Under our company's 2004 Stock Incentive Plan (the "2004 Plan"), if a "change in control" of our company occurs, then, unless the Compensation Committee decides otherwise either at the time of grant of an incentive award or at any time thereafter, all outstanding stock options will become immediately exercisable in full and will remain exercisable for the remainder of their terms, regardless of whether the participant to whom such options have been granted remains in the employ or service of our company or any subsidiary.

In addition, under the 2004 Plan, if a "change in control" of our company occurs, then, unless the Compensation Committee decides otherwise either at the time of grant of an incentive award or at any time thereafter:

- All outstanding stock appreciation rights will become immediately exercisable in full and will remain exercisable for the remainder of their terms, regardless of whether the participant to whom such stock appreciation rights have been granted remains in the employ or service of our company or any subsidiary;

- All outstanding restricted stock awards will become immediately fully vested and non-forfeitable; and

- All outstanding performance units, stock bonuses and performance stock awards will vest and/or continue to vest in the manner determined by the Compensation Committee and set forth in the agreement evidencing such performance units or stock bonuses.

There are presently no outstanding stock appreciation rights, performance units or stock bonuses.

In the event of a change in control, the Compensation Committee may pay cash for all or a portion of the outstanding options. The amount of cash the participants would receive will equal

(a) the fair market value of such shares immediately prior to the change in control minus (b) the exercise price per share and any required tax withholding.

Under the 2004 Plan, a "change in control" will include any of the following:

- The sale, lease, exchange or other transfer of all or substantially all of the assets of our company to a corporation not controlled by our company;
- The approval by our shareholders of a plan or proposal for the liquidation or dissolution of our company;
- Any change in control that is required by the Securities and Exchange Commission to be reported;
- Any person who was not a shareholder of our company on the effective date of the Plan becomes the beneficial owner of 50% or more of the voting power of our company's outstanding common stock; or
- The "continuity" directors (directors as of the effective date of the Plan and their future nominees) ceasing to constitute a majority of the Board of Directors.

The foregoing provisions applicable to changes in control under our 2004 Plan apply equally to all team members holding incentive awards under this plan.

Change in Control Provisions – 2010 Omnibus Incentive Plan

While the events that are considered a change in control under our 2004 Plan and Amended and Restated 2010 Omnibus Incentive Plan (the "2010 Plan") are identical, our 2010 Plan, which governs incentive awards granted in 2010 and future years, contains a "double-trigger" change in control provision. Under this provision, if the company is the surviving company, or the surviving or acquiring company assumes our outstanding incentive awards or provides for their equivalent substitutes, then vesting of incentive awards is accelerated only upon the termination of the team member's service, a material reduction in an team member's base salary, a discontinuation of participation in certain long-term cash or equity benefits provided to comparable team members, a significant change in job responsibilities or the need to relocate, provided these events occur within two years following a change in control.

Potential Payments to Named Executive Officers

The following table summarizes the amount of compensation and benefits payable to each named executive officer in the event of (i) any voluntary termination or resignation or termination for cause, (ii) an involuntary termination without cause, (iii) a change in control, (iv) a qualifying change in control termination, and (v) termination by reason of an executive's death or disability. The amounts shown assume that the applicable triggering event occurred on December 30, 2017 (fiscal year-end).

		Triggering Events				
Name	**Type of Payment**	**Voluntary/ Involuntary Termination For Cause ($)**	**Involuntary Termination without Cause[(1)] ($)**	**Change in Control ($)**	**Qualifying Change in Control Termination[(2)] ($)**	**Death or Disability ($)**
Shelly R. Ibach	Cash Severance[(3)]	---	$ 4,632,500	---	$ 6,460,000	---
	Option Award Acceleration[(4)]	---	$ 490,534	---	$ 1,516,485	$ 1,516,485
	Stock Award Acceleration[(5)]	---	$ 5,721,084	---	$ 9,279,556	$12,770,112
	Benefit Continuation[(6)]	---	$ 5,338	---	$ 5,338	---
	Outplacement	---	$ 15,000	---	$ 15,000	---
	Total	---	$10,864,456	---	$17,276,379	$14,286,597
David R. Callen	Cash Severance[(3)]	---	$ 915,351	---	$ 1,590,968	---
	Option Award Acceleration[(4)]	---	---	---	$ 306,303	$ 306,303
	Stock Award Acceleration[(5)]	---	---	---	$ 1,617,159	$ 1,987,383
	Benefit Continuation[(6)]	---	$ 13,503	---	$ 13,530	---
	Outplacement	---	$ 10,000	---	$ 10,000	---
	Total	---	$ 938,854	---	$ 3,537,960	$ 2,293,686
Andrew P. Carlin	Cash Severance[(3)]	---	$ 1,011,226	---	$ 1,746,662	---
	Option Award Acceleration[(4)]	---	---	---	$ 351,043	$ 351,043
	Stock Award Acceleration[(5)]	---	---	---	$ 2,563,112	$ 2,933,336
	Benefit Continuation[(6)]	---	$ 13,256	---	$ 13,256	---
	Outplacement	---	$ 10,000	---	$ 10,000	---
	Total	---	$ 1,034,482	---	$ 4,684,073	$ 3,284,379
Andrea L. Bloomquist	Cash Severance[(3)]	---	$ 881,572	---	$ 1,532,255	---
	Option Award Acceleration[(4)]	---	---	---	$ 308,404	$ 308,404
	Stock Award Acceleration[(5)]	---	---	---	$ 1,705,308	$ 2,075,532
	Benefit Continuation[(6)]	---	---	---	---	---
	Outplacement	---	$ 10,000	---	$ 10,000	---
	Total	---	$ 891,572	---	$ 3,555,967	$ 2,383,936
Suresh Krishna	Cash Severance[(3)]	---	$ 847,665	---	$ 1,473,323	---
	Option Award Acceleration[(4)]	---	---	---	$ 891,296	$ 891,296
	Stock Award Acceleration[(5)]	---	---	---	$ 2,062,601	$ 2,432,825
	Benefit Continuation[(6)]	---	$ 13,256	---	---	---
	Outplacement	---	$ 10,000	---	$ 10,000	---
	Total	---	$ 870,921	---	$ 4,437,220	$ 3,324,121

(1) If a named executive officer's employment is terminated by reason of involuntary termination without cause or their retirement at or beyond age fifty-five (55) and they have five (5) or more years of service with the company prior to retirement, the named executive officer will become vested in the stock and option awards pro rata based on the number of months elapsed in the restriction period as of the date of retirement. For stock and option awards granted in 2017, excluding the performance stock unit awards with a market condition described in greater detail in the Compensation Discussion and Analysis under the heading, "Special Performance-Vested LTI Awards", if a named executive officer is terminated by reason of retirement at or beyond age sixty (60) and they have five (5) or more years of service with the company prior to retirement, they are eligible to receive full vesting if they provide one-year notice of intention to retire (vesting is otherwise pro rata based on the number of months elapsed in the restriction period as of the date of retirement).

(2) The amounts payable to the named executive officers upon a change in control may be subject to reduction under Sections 280G and 4999 of the Internal Revenue Code.

(3) For the CEO, the cash severance compensation is equal to (a) two times the sum of (i) annual base salary and (ii) annual target cash incentive, plus (b) a pro rata portion of the CEO's annual cash incentive. For each of the other named executive officers, the cash severance compensation is equal to (a) one times the sum of (i) annual base salary and (ii) annual target cash incentive, plus (b) a pro rata portion of the executive's annual cash incentive.

[4] The value of the automatic acceleration of the vesting of unvested stock options held by a named executive officer is based on the difference between: (i) the fair market value of our common stock as of December 29, 2017 ($37.59), and (ii) the per share exercise price of the options held by the executive. The range of exercise prices of unvested stock options held by our named executive officers included in the table as of December 30, 2017 was $18.81 to $33.32.

[5] With the exception of the performance stock unit awards with a market condition granted in fiscal 2017 and described in greater detail in the Compensation Discussion and Analysis under the heading, "Special Performance-Vested RSU Awards", the value of the automatic acceleration of the vesting of stock awards held by a named executive officer is based on: (i) the number of unvested stock awards held by the executive as of December 30, 2017, multiplied by (ii) the fair market value of our common stock on December 29, 2017 ($37.59). For the performance stock units awards with a market condition granted in fiscal 2017, a qualifying change in control termination on December 30, 2017 would result in 33% of the target number of units vesting. As such, the value related to these performance stock unit awards with a market condition is reflected in the qualifying change in control termination column as (i) 33% of number of unvested units held by the executive as of December 30, 2017, multiplied by (ii) the fair value of our common stock on December 29, 2017 ($37.59).

[6] Represents the cost of "COBRA" medical and dental continuation coverage, less the amount paid by an active full-time employee for the same level of coverage.

Director Compensation

The following table summarizes the total compensation paid or earned by each of the non-employee members of our Board of Directors for the 2017 fiscal year ended December 30, 2017.

Name	Fees Earned or Paid in Cash ($)	Stock Awards[1] ($)	Option Awards[2] ($)	All Other Compensation ($)	Total ($)
Daniel I. Alegre	$ 79,750	$71,075	$23,278	---	$174,103
Stephen L. Gulis, Jr.[3]	$ 91,250	$71,075	$23,278	---	$185,603
Michael J. Harrison[3]	$ 81,250	$71,075	$23,278	---	$175,603
Brenda J. Lauderback[3]	$ 90,250	$71,075	$23,278	---	$184,603
Barbara R. Matas [3] [4]	$ 79,250	$71,075	$23,278	---	$173,603
Kathleen L. Nedorostek	$ 83,250	$71,075	$23,278	---	$177,603
Vicki A. O'Meara	$ 79,250	$71,075	$23,278	---	$173,603
Michael A. Peel[3]	$ 93,250	$71,075	$23,278	---	$187,603
Jean-Michel Valette	$178,750	$71,075	$23,278	---	$273,103

[1] Reflects the aggregate grant date fair value of 2,420 restricted stock awards granted during fiscal year 2017, computed in accordance with FASB ASC Topic 718. See Note 9, *Shareholders' Equity*, to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017, for a discussion of the relevant assumptions used in calculating these amounts. As of December 30, 2017, the aggregate number of shares outstanding under stock awards, including restricted stock, restricted stock units and phantom stock, held by those who served as non-employee directors during fiscal year 2017 was as follows: Mr. Alegre, 2,420 shares; Mr. Gulis, 66,886 shares; Mr. Harrison, 20,641 shares; Ms. Lauderback, 11,630 shares; Ms. Matas, 9,388 shares; Ms. Nedorostek, 14,512 shares; Ms. O'Meara, 2,420 shares; Mr. Peel, 13,608 shares, and Mr. Valette, 2,420 shares.

[2] Reflects the aggregate grant date fair value of 1,875 stock option awards granted during fiscal year 2017, computed in accordance with FASB ASC Topic 718. See Note 9, *Shareholders' Equity*, to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017, for a discussion of the relevant assumptions used in calculating these amounts. As of December 30, 2017, the aggregate number of stock options outstanding held by those who served as non-employee directors during fiscal 2017 was as

follows: Mr. Alegre, 11,357; Mr. Gulis, 22,232; Mr. Harrison, 14,826; Ms. Lauderback, 22,232; Ms. Matas, 4,122; Ms. Nedorostek, 17,232; Ms. O'Meara, 4,122; Mr. Peel 32,845; and Mr. Valette, 22,232.

(3) Under the 2010 Omnibus Incentive Plan, non-employee directors may elect to defer receipt of any shares of the company's common stock under an Incentive Award granted to non-employee directors under the Plan. For fiscal 2017, the following Directors have elected to defer receipt of their 2017 Incentive Award: Mr. Gulis, 2,420 shares; Mr. Harrison, 2,420 shares; Ms. Lauderback, 2,420 shares; Ms. Matas, 1,210 shares; and Mr. Peel, 2,420 shares.

(4) Ms. Matas elected to receive director fees in the form of common stock under the company's 2010 Omnibus Incentive Plan, and to defer receipt of such shares. The number of shares paid is determined by dividing the amount of the director's fees to be deferred by the fair market value per share of our common stock on the date the fees otherwise would have been payable in cash. The number of shares to be received by this director in lieu of cash compensation for fiscal 2017 is 2,668 shares and the related grant date fair value was $78,750.

Annual Retainer. In 2017, all of our non-employee directors received an annual cash retainer of $80,000 (increased from $75,000 in 2016). The Chairs of each of the Committees of the Board receive additional compensation of $10,000 per year. No Committee members other than the Chair receive additional compensation for service on any Committee. The non-executive Chairman of the Board receives an additional retainer of $100,000 per year.

Meeting Fees. Non-employee directors are entitled to payment of meeting fees for Board and Committee meetings beyond the normal number of regular or typical meetings for the Board and each Committee in a fiscal year. Pursuant to this approval, non-employee directors (other than the Chairman of the Board) are entitled to (i) Board meeting fees of $1,000 per in-person meeting and $500 per telephonic meeting after a minimum of four Board meetings for the fiscal year, and (ii) Committee meeting fees of $750 per in-person Committee meeting and $500 per telephonic Committee meeting after a minimum of eight Audit Committee meetings and after a minimum of four meetings of each other Committee for the fiscal year.

Equity Compensation. Coincident with the annual meeting of shareholders, non-employee directors are eligible to receive equity compensation in amounts determined by the Management Development and Compensation Committee, of which generally 75 percent would be paid in the form of restricted stock and 25 percent in stock options, based on Black-Scholes valuation, with the grants to vest on the earlier of one year from the date of grant or the date of the next annual meeting at which directors are elected to the Board, so long as the director continues to serve on our Board of Directors. All options granted to directors have an exercise price equal to the fair market value of our common stock on the date of grant and remain exercisable for a period of up to 10 years, subject to earlier termination following retirement from the Board.

Reimbursement of Expenses. All of our directors are reimbursed for travel expenses for attending meetings of our Board or any Board committee and for attending director continuing education programs.

No Director Compensation for Employee Directors. Any director who is also an employee of our company does not receive additional compensation for service as a director.

CEO Pay Ratio

Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires most companies with publicly traded stock in the United States to identify the median total compensation of their worldwide employee population (other than the chief executive officer) and to compare that amount with the total compensation of their chief executive officer. Total compensation amounts are required to be calculated using the SEC's compensation disclosure rules applicable to reporting compensation in the Summary Compensation Table of the proxy statement. Median employee compensation used to calculate the pay ratio is required to be the total compensation paid to an actual employee of the company. We identified our median employee using our total employee population as of December 30, 2017 by applying a consistently applied compensation measure across our employee population. For our consistently applied compensation measure, we included base wage, incentive compensation, commissions, over-time, paid time off, and holiday pay. We used this consistently applied compensation measure as it represents the primary compensation components paid to all of our employees. As a result, this compensation metric provides an accurate depiction of total annual compensation for the purpose of identifying our median employee. We then calculated the median employee's total annual compensation in accordance with the requirements of the Summary Compensation Table. We annualized compensation for new hire employees that did not have a full year of tenure in the calculation, but we did not annualize compensation for part-time employees or temporary or seasonal employees.

Our median employee's 2017 compensation was $52,130. Our Chief Executive Officer's total 2017 compensation was $7,290,429 as reported in the Summary Compensation Table on page 52. Accordingly, our 2017 CEO to Median Employee Pay Ratio was 140:1.

Please note that our Chief Executive Officer's total 2017 compensation includes a special performance-vested LTI award with grant value of $3,104,528, and this award is only earned for achievement of EPS of $2.75 in 2019. If this special award were excluded from the calculation to represent a more normalized rate of total compensation, our Chief Executive Officer's total 2017 compensation for the Summary Compensation Table would have been $4,185,901, and our 2017 CEO to Median Employee Pay Ratio would have been 80:1.

Please keep in mind that under the SEC's rules and guidance, there are numerous ways to determine the compensation of a company's median employee, including the employee population sampled, the elements of pay and benefits used, any assumptions made and the use of statistical sampling. In addition, no two companies have identical employee populations or compensation programs, and pay, benefits and retirement plans differ by country even within the same company. As such, our pay ratio may not be comparable to the pay ratio reported by other companies.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights[(1)]	Weighted average exercise price of outstanding options, warrants and rights[(3)]	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)[(4)]
Equity compensation plans approved by security holders	2,885,942[(2)]	$20.23	2,619,407
Equity compensation plans not approved by security holders	None	Not applicable	None
Total	2,885,942	$20.23	2,619,407

(1) Includes the Select Comfort Corporation 2004 Stock Incentive Plan and the Select Comfort Corporation 2010 Omnibus Incentive Plan.

(2) This amount includes 395,217 restricted stock units, 791,825 performance-based stock units, 270,895 market-based stock units, and 73,197 phantom shares. Performance-based stock units for which the performance period has not yet been completed are shown at target. The actual number of shares to be issued under performance-based stock unit awards depends on company performance against goals.

(3) The weighted average exercise price does not take into account the unvested restricted stock units, performance-based stock units, market-based stock units or phantom shares, which have no exercise price.

(4) The number of shares of common stock available for issuance under the 2010 Plan is reduced by 1.15 shares for each share issued pursuant to a “full value” award or potentially issuable pursuant to a “full value” award, which are awards other than stock options or SARs that are settled by the issuance of shares of our common stock.

ADVISORY VOTE TO APPROVE EXECUTIVE COMPENSATION (“Say-on-Pay”)

(Proposal 2)

Background

Consistent with the views expressed by shareholders at our 2017 Annual Meeting, the Board of Directors has determined to hold an advisory vote to approve executive compensation annually.

This advisory resolution, commonly referred to as “say-on-pay,” is non-binding on the company and the Board of Directors. However, the Board and the Management Development and Compensation Committee value the opinions of our shareholders and will carefully consider the outcome of the vote when making future compensation decisions.

As described more fully in the Compensation Discussion and Analysis section of this Proxy Statement, our compensation programs are structured to align the interests of our executive officers with the interests of our shareholders. They are designed to attract, retain, and motivate a talented management team to preserve its competitive advantage in the marketplace and deliver sustainable profitable growth. Shareholders are urged to read the CD&A, which discusses in-depth how our executive compensation programs are aligned with our performance and the creation of shareholder value.

Proposal

The Board of Directors recommends that shareholders vote “For” approval of the following non-binding advisory resolution at the 2018 annual meeting:

> RESOLVED, that the shareholders of Sleep Number Corporation approve, on an advisory basis, the compensation of the company’s named executive officers as described in the Compensation Discussion and Analysis, tabular disclosures and other executive compensation narrative provided in this Proxy Statement for the company’s 2018 Annual Meeting of Shareholders.

Vote Required

The affirmative vote of the holders of a majority of the shares of common stock present and entitled to vote in person or by proxy on this matter at the Annual Meeting, and at least a majority of the minimum number of shares necessary for a quorum, is necessary for approval of the foregoing resolution. Unless a contrary choice is specified, proxies solicited by the Board of Directors will be voted “**For**” approval of the foregoing resolution.

AUDIT COMMITTEE REPORT

The Audit Committee of the Board of Directors is responsible for providing independent, objective oversight with respect to our company's accounting and financial reporting functions, internal and external audit functions, systems of internal controls regarding financial matters and legal, ethical and regulatory compliance. The Audit Committee operates under a written charter approved by the Board of Directors. A copy of the charter is available at the investor relations section of the company's website at *http://www.sleepnumber.com/sn/en/investor-relations*.

The Audit Committee is currently composed of four directors, each of whom is independent as defined by the NASDAQ listing standards and SEC Rule 10A-3. Stephen L. Gulis, Jr. (Chair), Brenda J. Lauderback, Barbara R. Matas and Vicki A. O'Meara served on the Audit Committee throughout 2017 and through the date of this report. Michael J. Harrison served on the Audit Committee from the beginning of 2017 and through the annual meeting of shareholders in May of 2017.

Management is responsible for our company's financial reporting processes and internal control over financial reporting. Deloitte & Touche LLP, our Independent Registered Public Accounting Firm, is responsible for auditing our company's consolidated financial statements for the 2017 fiscal year. This audit is to be conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States). The Audit Committee's responsibility is to monitor and oversee these processes.

In connection with these responsibilities, the Audit Committee met in person or by telephone conference eight times during 2017. These meetings involved representatives of management, internal audit and the independent auditors. At each of its regularly scheduled quarterly meetings, the Audit Committee meets in executive session and also meets in separate executive sessions with representatives of the Independent Registered Public Accounting Firm and with the executive who leads our internal audit function.

Management represented to the Audit Committee that our company's consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America. The Audit Committee has reviewed and discussed the consolidated financial statements, together with the results of management's assessment of the company's internal control over financial reporting, with management and the Independent Registered Public Accounting Firm. The Audit Committee discussed with the Independent Registered Public Accounting Firm the matters required to be discussed with the auditors under Statement on Auditing Standards No. 61 "Communication with Audit Committees" (Codification of Statements on Auditing Standards, AU 380), as amended. The Independent Registered Public Accounting Firm provided the Audit Committee with written disclosures and the letter required by applicable requirements of the Public Company Accounting Oversight Board, and the Audit Committee discussed with the Independent Registered Public Accounting Firm that firm's independence.

Based upon the Audit Committee's discussions with management, internal audit and the Independent Registered Public Accounting Firm, and the Audit Committee's review of the representations of management and the Independent Registered Public Accounting Firm, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements be included in our company's Annual Report on Form 10-K for the year ended December 30, 2017, for filing with the Securities and Exchange Commission.

This Audit Committee Report shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.

The Audit Committee of the Board of Directors

Stephen L. Gulis, Jr., Chair
Brenda J. Lauderback
Barbara R. Matas
Vicki A. O'Meara

RATIFICATION OF SELECTION
OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

(Proposal 3)

Selection of Independent Registered Public Accounting Firm

The Audit Committee of our Board of Directors selected Deloitte & Touche LLP ("Deloitte") as the company's independent registered public accounting firm ("Independent Auditors") for the 2018 fiscal year ending December 29, 2018. Deloitte has served as our Independent Auditors since the 2010 fiscal year.

Although the Board is not required to submit the selection of Independent Auditors to shareholders for ratification, and the Board would not be bound by shareholder ratification or failure to ratify the selection, the Board wishes to submit the selection of Deloitte to serve as our Independent Auditors for the 2018 fiscal year to our shareholders for ratification consistent with best practices in corporate governance.

If shareholders do not ratify the selection of Deloitte as our Independent Auditors, the Audit Committee will reconsider whether to retain Deloitte and may determine to retain that firm or another firm without resubmitting the matter to shareholders. Even if the selection of Deloitte is ratified by shareholders, the Audit Committee may, in its discretion, direct the appointment of a different firm of Independent Auditors at any time during the year if it determines that such a change would be in the best interests of the company and our shareholders.

Representatives of Deloitte will be present at the Annual Meeting, will have an opportunity to make a statement if they so desire and will be available to respond to questions from shareholders.

Audit and Other Fees

The aggregate fees billed for professional services by the Independent Auditors in 2017 and 2016 were:

	2017	2016
Audit fees (1)	$585,805	$554,000
Audit-related fees (2)	1,895	2,000
Audit and audit-related fees	$587,700	$556,000
Tax fees (3)	98,182	124,119
All other fees (4)	33,673	---
Total	$719,555	$680,119

---

(1) Audit fees in 2017 and 2016 include fees incurred for the annual audit and quarterly reviews of the company's consolidated financial statements and the annual audit of the company's internal control over financial reporting for the years ended December 30, 2017 and December 31, 2016, respectively.

(2) These fees related to access to an online accounting research tool.

(3) These fees are primarily for tax compliance services based on time and materials. The 2016 amount also includes fees of $51,000 related to our acquisition of BAM Labs, Inc.

(4) These fees relate to consulting services.

Under the Sarbanes-Oxley Act of 2002 and the rules of the Securities and Exchange Commission regarding auditor independence, the engagement of the company's Independent Auditors to provide audit or non-audit services for the company must either be approved by the Audit Committee before the engagement or entered into pursuant to pre-approval policies and procedures established by the Audit Committee. Our Audit Committee has not established any pre-approval policies or procedures and therefore all audit or non-audit services performed for the company by the Independent Auditors must be approved in advance of the engagement by the Audit Committee. Under limited circumstances, certain de minimus non-audit services may be approved by the Audit Committee retroactively. All services provided to the company by the Independent Auditors in 2017 were approved in advance of the engagement by the Audit Committee and no non-audit services were approved retroactively by the Audit Committee pursuant to the exception for certain de minimus services described above.

Board Recommendation

The Board recommends a vote "**For**" ratification of the selection of Deloitte as our Independent Auditors for the 2018 fiscal year ending December 29, 2018. Unless a contrary choice is specified, proxies solicited by the Board will be voted "**For**" the ratification of the selection of Deloitte as Independent Auditors.

Vote Required

Assuming a quorum is present, the affirmative vote of the holders of a majority of the shares of common stock present and entitled to vote in person or by proxy on this matter at the Annual Meeting is necessary for approval of this proposal. Unless a contrary choice is specified, proxies solicited by the Board of Directors will be voted "For" approval of this proposal.

OTHER MATTERS

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our Directors and executive officers and all persons who beneficially own more than 10% of the outstanding shares of our common stock to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock. Executive officers, Directors and greater than 10% beneficial owners are also required to furnish us with copies of all Section 16(a) forms they file. To our knowledge, based upon a review of the copies of such reports furnished to us during the 2017 fiscal year ended December 30, 2017 and written representations by such persons, all reports were filed on a timely basis.

Shareholder Proposals for 2019 Annual Meeting

Any shareholder proposal requested to be included in the proxy materials for the 2019 Annual Meeting of Shareholders must (i) be received by our Senior Vice President, Chief Legal and Risk Officer and Secretary on or before December 7, 2018 and (ii) satisfy all of the requirements of, and not otherwise be permitted to be excluded under, Rule 14a-8 promulgated by the SEC and our Bylaws.

Our Bylaws require advance written notice to our company of shareholder-proposed business or of a shareholder's intention to make a nomination for Director at an annual meeting of shareholders. They also limit the business which may be conducted at any special meeting of shareholders to business brought by the Board.

Specifically, the Bylaws provide that business may be brought before an annual meeting by a shareholder only if the shareholder provides written notice to the Secretary of our company not less than 120 days prior to the first anniversary of the date that we first released or mailed our proxy materials to shareholders in connection with the preceding year's annual meeting. Under these provisions, notice of a shareholder proposal to be presented at the 2019 Annual Meeting of Shareholders (but that is not requested to be included in the proxy materials) must be provided to the Secretary of our company on or before December 7, 2018. In the event, however, that the date of the annual meeting is advanced by more than 30 days or delayed by more than 60 days from the anniversary of the preceding year's annual meeting date, notice by the shareholder to be timely must be so delivered not later than the close of business on the later of the 120th day prior to such annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made.

A shareholder's notice must set forth:

- A description of the proposed business and the reasons for it,
- The name and address of the shareholder making the proposal,
- The class and number of shares of common stock owned by the shareholder, and

- A description of any material interest of the shareholder in the proposed business.

Our Bylaws also provide that a shareholder may nominate a Director at an annual meeting only after providing advance written notice to the Secretary of our company within the time limits described above. The shareholder's notice must set forth all information about each nominee that would be required under SEC rules in a proxy statement soliciting proxies for the election of such nominee, as well as the nominee's business and residence address. The notice must also set forth the name and record address of the shareholder making the nomination and the class and number of shares of common stock owned by that shareholder. The required procedures for a shareholder to nominate a Director are described in more detail above under the heading "Corporate Governance – Director Nominations Process."

Other Business

Management of our company does not intend to present other items of business and knows of no items of business that are likely to be brought before the Annual Meeting except those described in this Proxy Statement. However, if any other matters should properly come before the Annual Meeting, the persons named in the enclosed proxy will have discretionary authority to vote such proxy in accordance with the best judgment on such matters.

Copies of 2017 Annual Report

We will furnish to our shareholders without charge a copy of our Annual Report on Form 10-K (without exhibits) for the 2017 fiscal year ended December 30, 2017. Any request for an Annual Report should be sent to:

Sleep Number Corporation
Investor Relations Department
1001 Third Avenue South
Minneapolis, Minnesota 55404

Householding Information

"Householding" is a program, approved by the SEC, which allows companies and intermediaries (e.g. banks and brokers or other nominees) to satisfy the delivery requirements for proxy statements and annual reports by delivering only one package of shareholder proxy material to any household at which two or more shareholders reside. If you and other residents at your mailing address own shares of our common stock in a "street name," your broker or bank may have notified you that your household will receive only one copy of our proxy materials. Once you have received notice from your broker that they will be "householding" materials to your address, "householding" will continue until you are notified otherwise or until you revoke your consent. Any shareholder who is receiving multiple copies of these documents and would like to receive only one copy per household should contact the shareholder's bank, broker or other nominee record holder. If you hold shares of our common stock in your own name as a holder of record, "householding" will not apply to your shares.

We will promptly deliver an additional copy of any of these documents to you if you call us at (763) 551-7498 or write us at the following address:

Sleep Number Corporation
Investor Relations Department
1001 Third Avenue South
Minneapolis, Minnesota 55404

Your vote is important. Whether or not you plan to attend the Annual Meeting, please vote your shares of common stock "For" the Board's nominees and "For" each of the other proposals before you at the Annual Meeting promptly by mail, telephone, or Internet as instructed on your proxy card.

By Order of the Board of Directors

Mark A Kimball

Mark A. Kimball
Senior Vice President,
Chief Legal and Risk Officer and Secretary

April 6, 2018
Minneapolis, Minnesota

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

FORM 10-K

(Mark one)

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

For the Fiscal Year Ended December 30, 2017

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

For the transition period from _________ to _________.

Commission File No. 0-25121

SLEEP NUMBER CORPORATION

(Exact name of registrant as specified in its charter)

MINNESOTA	**41-1597886**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1001 Third Avenue South **Minneapolis, Minnesota**	**55404**
(Address of principal executive offices)	(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

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

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. YES ☒ NO ☐

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☒ NO ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	☒		Accelerated filer ☐
Non-accelerated filer	☐	(Do not check if a smaller reporting company)	Smaller reporting company ☐
			Emerging growth company ☐

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 ☒

The aggregate market value of the common stock held by non-affiliates of the Registrant as of July 1, 2017, was $882,558,000 (based on the last reported sale price of the Registrant's common stock on that date as reported by NASDAQ).

As of January 26, 2018, there were 38,487,000 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement to be furnished to shareholders in connection with its 2018 Annual Meeting of Shareholders are incorporated by reference in Part III, Items 10-14 of this Annual Report on Form 10-K.

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

As used in this Form 10-K, the term "bedding" includes mattresses, box springs and foundations.

Sleep Number®, SleepIQ®, Sleep Number 360®, SleepIQ Kids®, the Double Arrow logo, Select Comfort®, AirFit®, BAM Labs®, the "B" logo, Comfortaire®, ComfortFit®, Comfort.Individualized.®, Does Your Bed Do That?®, the DualTemp logo, the DualAir Technology Inside logo, FlexTop®, IndividualFit®, Individualized Sleep Experiences®, It®, Know Better Sleep®, Pillow [ology]®, PillowFit®, Probably the Best Bed in the World®, Sleep Number Inner Circle®, Tech-e®, Smart Bed For Smart Kids®, Smart Bed Technology®, The Only Bed That Grows With Them®, The Only Bed That Knows You®, Tonight Bedtime. Tomorrow The World®, We Make Beds Smart®, What's Your Sleep Number?®, SleepIQ LABS™, Auto Snore™, HealthIQ™, HeartIQ™, Rapid Sleep Onset™, RespiratoryIQ™, Responsive Air™, Sleep For The Future℠, Sleep Is My Super Power™, Sleep Is Training™, Sleep30™, WellnessIQ™, ActiveComfort™, CoolFit™, DualAir™, DualTemp™, Firmness Control™, FlexFit™, In Balance™, PartnerSnore™, The Bed Reborn™, the SleepIQ LABS logo, The Bed That Moves You™, our bed model names, and our other marks and stylized logos are trademarks and/or service marks of Sleep Number. This Form 10-K may also contain trademarks, trade names and service marks that are owned by other persons or entities.

Our fiscal year ends on the Saturday closest to December 31, and, unless the context otherwise requires, all references to years in this Form 10-K refer to our fiscal years. Our fiscal year is based on a 52- or 53-week year. All years presented in this Form 10-K are 52 weeks, except for the 2014 fiscal year ended January 3, 2015, which is a 53-week year.

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PART I

This Annual Report on Form 10-K contains or incorporates by reference certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For this purpose, any statements contained in or incorporated by reference into this Annual Report on Form 10-K that are not statements of historical fact may be deemed to be forward-looking statements, including but not limited to projections of revenues, results of operations, financial condition or other financial items; any statements of plans, strategies and objectives of management for future operations; any statements regarding proposed new products, services or developments; any statements regarding future economic conditions, prospects or performance; statements of belief and any statement or assumptions underlying any of the foregoing. In addition, we or others on our behalf may make forward-looking statements from time to time in oral presentations, including telephone conferences and/or Webcasts open to the public, in press releases or reports, on our Internet Website or otherwise. We try to identify forward-looking statements in this report and elsewhere by using words such as "may," "will," "should," "could," "expect," "anticipate," "believe," "estimate," "plan," "project," "predict," "intend," "potential," "continue" or the negative of these or similar terms.

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

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

ITEM 1. BUSINESS

Overview

Sleep Number Corporation (formerly Select Comfort Corporation), based in Minneapolis, Minnesota, was founded in 1987. In 1998, Sleep Number became a publicly traded company. We are listed on The NASDAQ Stock Market LLC (NASDAQ Global Select Market) under the symbol "SNBR." When used herein, the terms "Sleep Number," "Company," "we," "us" and "our" refer to Sleep Number Corporation, including consolidated subsidiaries.

Our mission is to improve lives by individualizing sleep experiences. Our vision is to become one of the world's most beloved brands by delivering an unparalleled sleep experience. We expect to achieve our goals by executing our consumer innovation strategy with three significant competitive advantages: proprietary sleep innovations, lifelong customer relationships and exclusive retail distribution.

As the leader in sleep innovation, Sleep Number delivers the best quality sleep through effortless, adjustable comfort and biometric sleep tracking. We are a visionary in health and wellness, proving the connection between sleep and well-being. We have a vertically integrated business model and are the exclusive designer, manufacturer, marketer, retailer and servicer of Sleep Number beds. We offer consumers high-quality, individualized sleep solutions and services, including a complete line of Sleep Number beds, bases and bedding accessories. We are the pioneer in biometric sleep tracking and adjustability. Only the Sleep Number bed offers SleepIQ technology - a proprietary sensor technology that tracks each individual's sleep and works directly with the bed's DualAir system to automatically adjust the comfort level of each sleeper. With the SleepIQ technology platform, we are powering one of the most comprehensive databases of biometric sleep data in the world, and fundamentally changing the way we monitor and manage health. Through daily digital interactions that build lifelong relationships, SleepIQ technology also communicates how you slept and provides insights on what adjustments you can make to optimize your sleep and improve your daily life. Sleep Number also offers FlextFit adjustable bases, Sleep Number pillows, sheets and other bedding products. As a direct-to-consumer brand, we offer consumers a cohesive experience across our Sleep Number stores, online at SleepNumber.com or via phone at (800) 753-3768.

We are committed to delivering superior shareholder value through three primary drivers of earnings per share growth: increasing consumer demand, leveraging our business model and deploying capital efficiently. Since 2012, we have transformed the business with $487 million of capital expenditures and acquisitions. This effort has strengthened our competitive advantages and positioned us for accelerated profits and cash generation. In 2017, we increased net sales by 10% to $1.4 billion and increased operating income by 20% to $92 million.

In September 2015, we completed the acquisition of BAM Labs, Inc. (now operating as SleepIQ LABS), the leading provider of biometric sensor and sleep monitoring technology for data-driven health and wellness. The addition of SleepIQ LABS strengthens Sleep Number's leadership in sleep innovation, adjustability and individualization. The acquisition broadens and deepens electrical, biomedical, software and backend capabilities - API (application program interface) and bio-signal analysis. Our ownership and control of biometric data advances smart, connected products that empower our customers to experience quality sleep.

In the fourth quarter of 2015, we replaced our nearly 20-year-old legacy computer systems with a new vertically integrated Enterprise Resource Planning (ERP) system. The new operating platform enables operational efficiencies, improves customer convenience and supports the growth of our business.

Proprietary Sleep Innovations

The Sleep Number 360® Smart Bed

In January 2017 at CES (the world's preeminent technology showcase and innovation catalyst), Sleep Number introduced the Sleep Number 360 smart bed line, the most significant innovation in our 30-year history. The Sleep Number 360 smart bed won 13 awards at CES, including being named the Best of Innovation Honoree in the Home Appliances category. Powered by SleepIQ technology, the Sleep Number 360 smart beds intuitively sense and automatically adjust comfort to keep both partners sleeping soundly all night. The SleepIQ technology platform integrates hardware, software and design to deliver effortless adjustability, sleep tracking and connectivity.

The Sleep Number 360 smart mattresses and FlexFit smart adjustable bases will include these features that deliver improved quality sleep:

- Self-adjusting comfort throughout the night. As sleep positions change during the night, Responsive Air technology adjusts the bed's comfort via the two air chambers inside the mattress.
- Foot-warming feature to fall asleep faster. It's clinically proven that people fall asleep faster when their feet are warmed. SleepIQ technology knows the sleepers' bedtime routines and warms the foot of the bed before bedtime with Rapid Sleep Onset technology.
- Partner Snore adjustment. At the touch of a button, the 360 Smart Bed will elevate your partner's head, which may relieve mild common snoring.

As of December 30, 2017, we have deployed three smart bed models: the p6, i7 and i10 Sleep Number 360 smart beds. The remainder of the 360 smart bed line will also be deployed in phases and we expect to have the core line transitioned by mid-year 2018.

Sleep Number® Bed Offerings

Unlike the "one-size-fits-all" solution offered by other mattress brands, the Sleep Number bed offers individualized comfort that is adjustable on each side of the bed. Our proprietary DualAir technology, which features two independent air chambers, allows couples to adjust firmness to their own individual preference at the touch of a button. Sleepers can each enjoy their ideal firmness, support and pressure-relieving comfort - their Sleep Number setting - for deep, restful sleep.

The benefits of our proprietary Sleep Number bed have been validated through clinical sleep research, which has shown that participants who slept on a Sleep Number bed generally fell asleep faster, experienced more deep sleep with fewer disturbances and experienced greater relief from back pain than those sleeping on a traditional innerspring mattress.

We offer Sleep Number beds in good, better and best price ranges within the premium mattress category, and in a broad range of sizes, including twin, full, queen, eastern king and California king.

- The Classic Series offers Sleep Number adjustability starting at $899 for a queen mattress. The series includes the Sleep Number c2 and c4 beds.
- The Performance Series includes our most popular mattresses with a perfect balance of softness and pressure-relieving support. The series includes the Sleep Number p5 bed and Sleep Number 360 p6 smart bed.
- The Innovation Series is the ultimate in individualized comfort and temperature-balancing innovation, including the Sleep Number i8 bed, the Sleep Number 360 i7 smart bed and the 360 i10 smart bed.

Our commitment to quality, value, and service has been recognized by customers through J.D. Power. The J.D. Power's survey measures customer satisfaction with mattress purchases based on seven factors: comfort, price, support, durability, warranty, features and customer service. Sleep Number was ranked highest in customer satisfaction with mattresses in 2016 and 2017, and second highest in 2018.

SleepIQ® Technology

SleepIQ technology is a touchless, biometric sensor technology that tracks sleep during the night. Launched by Sleep Number in 2014, SleepIQ technology tracks the user's sleep by gathering hundreds of biometric readings per second continuously (heart rate, motion and breathing). The accuracy of SleepIQ technology heart rate, breath rate and movement measurements has been validated through in-home trials and sleep center studies. Based on this data, a proprietary algorithm delivers a personal SleepIQ score, from 1 to 100, to consumers each morning. SleepIQ also connects with leading health, fitness and sleep environment apps - including Apple® Health, FitBit®, Nest Learning Thermostat™, MapMyRun™ and Nokia Health Mate™ - to show a holistic view of how lifestyle choices may affect sleep.

The Sleep Number bed is the only bed that lets you track and optimize your sleep with SleepIQ technology. It empowers the sleeper to achieve their best possible sleep each night. In addition, SleepIQ can be added to Sleep Number beds purchased after 2008.

FlexFit™ Adjustable Base Technology

We offer a full line of exclusive FlexFit adjustable bases that enable customers to raise the head or foot of the bed, and to experience the comfort of massage. Our Partner Snore technology lets a user gently raise their partner's head to relieve mild common snoring.

In conjunction with the 360 smart beds, we introduced a new line of FlexFit smart adjustable bases in 2017. This new series integrates with SleepIQ technology to deliver the new features and functionality previously described, and will replace our existing FlexFit base models.

Additional Sleep Number Innovations

Our exclusive Sleep Number bedding collection comprises a full line of sleep products that are designed to solve sleep issues. Sleep Number has a wide assortment of pillows designed to fit each individual's size, shape and sleeping position for more comfortable sleep. Our innovative bedding features make it easier to make your bed: our SmartFit design keeps sheets securely in place and Logic Label takes the guesswork out of making your bed. We also offer a wide assortment of temperature-balancing products including a DualTemp layer. This proprietary sleep innovation features active air technology that allows each person to select his or her ideal temperature at the simple touch of a button and can be used with any mattress brand or adjustable base.

The SleepIQ Kids bed extends Sleep Number's core DualAir adjustability and SleepIQ technology to the children's mattress market via two models, the k1 and the k2. It is the only bed that adjusts with children as they grow.

Exclusive Distribution

With the importance of building a brand relationship directly with consumers, nearly 99% of our net sales are direct to consumers through a cohesive experience across our Sleep Number stores, online at SleepNumber.com or via phone.

Since 2012, we have rebuilt our store portfolio and expanded our national footprint. This strategy has included repositioning a large percentage of our mall stores to stronger off-mall locations, improving the size and positioning within malls and adding stores in both existing and new trade areas. We are well positioned with a healthy retail store portfolio that is highly productive. As of year-end 2017, approximately 49% of our stores are less than five years old.

We target high-quality, convenient and visible store locations based on several factors, including each market's overall sales potential, store geographic location, demographics and proximity to other specialty retail stores. As the exclusive distributor of Sleep Number products, we target one store per 350,000 - 500,000 people. This places our stores within an average radius of 10 miles, or 20-minute drive times, for most of our target customers.

Our award-winning store design and improved real estate locations support our value-added retail experience, which results in high store productivity and profitability. Our stores deliver nearly $1,000 of annual net sales per square foot and we average approximately $667,000 in annual net sales per full-time retail employee. Since 2012, we have increased our average store size by more than 58% to 2,647 square feet.

As of December 30, 2017, we had 556 retail stores in all 50 U.S. states, including new stores opened in Alaska and Hawaii, 57% of which were in non-mall locations. We have targeted up to 650 stores by 2019.

Working in conjunction with our retail stores, we have a cohesive online experience that helps customers easily engage in relevant content, research our products and solutions, transact online and find post-sales support. Our experience expands our digital brand connecting with consumers to drive deeper awareness, consideration and engagement.

We have adopted an agile development approach to our online initiatives. This means we deploy rapid experimentation and iterations of our digital experiences. Results include faster time-to-market of online improvements to drive store traffic and online conversion. Sleep Number products are available exclusively at SleepNumber.com or Sleep Number stores.

Our retail business accounted for 92% of our net sales in 2017. Average annual net sales per comparable store were $2.4 million in 2017. In 2017, 98% of our stores open for a full year generated net sales over $1 million and 61% of our stores open for a full year generated net sales over $2 million. We now have more than 20% of our store base delivering greater than $3 million in annual net sales. In 2017, our online and phone sales accounted for 7% of our net sales and wholesale accounted for 1% of our net sales.

Marketing

We use a broad set of marketing and advertising instruments to extend brand reach, deepen brand engagement, and motivate and educate customers for traffic to our brand. Our actions result in acquiring new customers and driving referral and repeat business. Our marketing efforts target a broad customer demographic: 30-54 years old with greater than $75,000 household income for our core line of products. Our customers care about their own and their family's sleep quality and know that it leads to better overall health and well-being.

Marketing drives growth in our business by building brand relevance, reputation, consumer awareness, consideration and ongoing engagement with our benefit-driven sleep innovations, which results in increased quality traffic to our website and stores. Our advertising communications utilize a mix of national and local marketing to target existing customers for referral and repeat purchases and to attract new customers. Television is our most efficient media, followed by digital and social media. We continue to build our in-house digital capabilities, content marketing, user experience and data-driven tools to make deeper connections with our customers, increase brand demand and improve media efficiency. In 2017, media expense represented 13.4% of net sales.

In early 2018, we entered into a multi-year partnership as the official sleep and wellness partner of the NFL aimed at amplifying our brand, our analytics and loyal customer-base. We will help players compete more effectively by measuring, understanding and maximizing the benefits of a great night's sleep. Sleep Number will work with players, teams and trainers as they integrate sleep insights into their overall performance regimens.

Operations

Manufacturing and Distribution

We have two manufacturing plants located in Irmo, South Carolina and Salt Lake City, Utah. The manufacturing operations in South Carolina and Utah consist of cutting and sewing of the fabric covers for our beds, and final assembly and packaging of mattresses and bases. In addition, our electrical Firmness Control systems are assembled in our Utah plant.

We obtain all the raw materials and components used to produce our beds from outside sources. A number of components, including our proprietary air chambers, our adjustable foundations, various components for our Firmness Control systems, as well as fabrics and zippers, are sourced from suppliers who currently serve as our sole or primary source of supply for these components. We believe we can obtain these raw materials and components from other sources of supply, although we could experience some short-term disruption in our ability to fulfill orders in the event of an unexpected loss of supply from one of our primary suppliers. We utilize dual sourcing on targeted components when effective.

We have taken, and continue to take, various measures to mitigate the potential impact of an unexpected disruption in supply from any sole-source suppliers, including increasing safety stocks and identifying potential secondary sources of supply. All the suppliers that produce unique or proprietary products for us have in place either contingency or disaster recovery plans or redundant production capabilities in other locations in order to safeguard against any unforeseen disasters. We review these plans and sites on a regular basis to ensure the suppliers' ability to maintain an uninterrupted supply of materials and components.

Historically, we manufactured our bed components in our two plants and completed final bed assembly in customers' homes. We are pursuing a multi-year evolution to enable delivery of assembled mattresses. In 2017, we opened two assembly distribution centers to assemble beds prior to delivery. We expect to expand this capability to approximately six assembly distribution centers over the next couple of years. We are also advancing our outbound logistics network to reduce product handling, hand-offs, damage and costs while in transit to customers' homes. We see these initiatives providing a superior and reliable experience for customers with lower costs for the business.

Home Delivery Service

Nearly 85% of our beds sold are installed through our full-service home delivery team or by our third-party service providers in selected markets. The balance of beds are shipped directly to our customers and self-assembled.

Customer Service

We have an in-house customer service team of specialists that provide service and support via phone, email, "live chat" and social media. Direct access to our customers is a unique advantage that also provides insights and identifies emerging trends as we strive to continuously improve our product and service quality and advance our product innovation.

Research and Development

As a consumer-driven innovation company, Sleep Number conducts extensive research to understand consumer needs. This research informs the design and delivery of our sleep innovations and our customer experience. We have a robust product development organization that fuels our innovations. In 2015, we acquired BAM Labs, Inc. (now operating as SleepIQ LABS), a leading provider of biometric sensor and sleep monitoring for data-driven health and wellness. This is significant as consumers are rapidly adopting new digital tools and using their personal data to improve health and wellness. Technology that improves the quality of sleep and overall wellness will continue to be a top priority for Sleep Number. Our research and development expenses were $28 million in 2017, $28 million in 2016 and $16 million in 2015.

Management Information Systems

We use information technology systems to operate, analyze and manage our business, to reduce operating costs and to enhance our customers' experience. Our major systems include an in-store order entry system, a retail portal system, a payment processing system, in-bound and out-bound telecommunications systems for direct marketing, delivery scheduling and customer service, e-commerce systems, a data warehouse system and an enterprise resource planning system. These systems are primarily comprised of packaged applications licensed from various software vendors plus a limited number of internally developed programs. Please refer to the information set forth in Part I, Item 1A., *Risk Factors,* for a discussion of certain risks that may be encountered in connection with our management information systems.

Intellectual Property

We hold various U.S. and foreign patents and patent applications regarding certain elements of the design and function of our products, including air control systems, remote control systems, air chamber features, mattress construction, foundation systems, sensing systems, as well as other technology. We have numerous U.S. patents, expiring at various dates between February 2019 and November 2035, and numerous U.S. patent applications pending. We also have numerous foreign patents and patent applications pending. Notwithstanding these patents and patent applications, we cannot ensure that these patent rights will provide substantial protection or that others will not be able to develop products that are similar to or competitive with our products.

We have a number of trademarks and service marks registered with the U.S. Patent and Trademark Office, including Sleep Number®, SleepIQ®, Sleep Number 360®, SleepIQ Kids®, the Double Arrow logo, Select Comfort®, AirFit®, BAM Labs®, the "B" logo, Comfortaire®, ComfortFit®, Comfort.Individualized.®, Does Your Bed Do That?®, the DualTemp logo, the DualAir Technology Inside logo, FlexTop®, IndividualFit®, Individualized Sleep Experiences®, It®, Know Better Sleep®, Pillow[ology]®, PillowFit®, Probably the Best Bed in the World®, Sleep Number Inner Circle®, Tech-e®, Smart Bed For Smart Kids®, Smart Bed Technology®, The Only Bed That Grows With Them®, The Only Bed That Knows You®, Tonight Bedtime. Tomorrow The World®, We Make Beds Smart®, and What's Your Sleep Number?®. We have several trademarks that are the subject of pending applications, including SleepIQ LABS™, Auto Snore™, HealthIQ™, HeartIQ™, Rapid Sleep Onset™, RespiratoryIQ™, Responsive Air™, Sleep for the Future℠, Sleep Is My Super Power™, Sleep Is Training™, Sleep30™ and WellnessIQ™. Each registered mark is renewable indefinitely as long as the mark remains in use and/or is not deemed to be invalid or canceled. We also have a number of common law trademarks, including ActiveComfort™, CoolFit™, DualAir™, DualTemp™, Firmness Control™, FlexFit™, In Balance™, PartnerSnore™, the SleepIQ LABS logo, The Bed Reborn™, The Bed That Moves You™ and our bed model names. Several of our trademarks have been registered, or are the subject of pending applications for registration, in various foreign countries. We also have other intellectual property rights related to our products, processes and technologies, including trade secrets, trade dress and copyrights. We protect and enforce our intellectual property rights, including through litigation as necessary.

Industry and Competition

The U.S. bedding industry is a mature and generally stable industry. According to the International Sleep Products Association (ISPA), the industry has grown by approximately 5% annually over the last 20 years and at an estimated 6% annually, on average, over the past five years. We believe that industry unit growth has been primarily driven by population growth, an increase in the number of homes (including secondary residences) and the increased size of homes. We believe growth in average wholesale prices resulted from a shift to both larger and higher-quality beds, which are typically more expensive. According to ISPA, industry wholesale shipments of mattresses and foundations (excluding adjustable bases) were estimated to be $8.5 billion in 2017 compared to $8.4 billion in 2016. *Furniture/Today,* a furniture industry trade publication, has ranked Sleep Number as the 5th largest mattress manufacturer and 2nd largest U.S. bedding retailer for 2016, with a 7% market share of industry retail revenue.

The retail bedding industry is fragmented and highly competitive. Our Company-Controlled distribution channel is exclusive, and we compete against regional and local specialty bedding retailers, home furnishing stores, mass merchants, national discount stores and online marketers. Our consumer innovation strategy with exclusive distribution is highly differentiated, and results in retail-leading customer experience.

Manufacturers in the bedding industry compete on price, quality, brand name recognition, product availability and product performance, including the perceived levels of comfort and support provided by a mattress. There is a high degree of concentration among manufacturers, who produce innerspring, memory foam and hybrid beds, under nationally recognized brand names, including Tempur Sealy, Stearns & Foster, Serta and Simmons. In recent years, numerous (over 100) direct-to-consumer companies and low cost importers have entered the market, offering “bed-in-a-box” products to consumers primarily through the Internet. These companies market directly to consumers, competing primarily on convenience of online shopping and speed of delivery. Their products are generally foam-based and undifferentiated in terms of sleep benefits.

Governmental Regulation and Compliance

As a vertically integrated manufacturer and retailer, we are subject to extensive federal, state and local laws and regulations affecting all aspects of our business.

As a manufacturer, we are committed to product quality and safety, including adherence to all applicable laws and regulations affecting our products. Compliance with federal fire retardant standards developed by the U.S. Consumer Product Safety Commission, including rigorous and costly testing, has increased the cost and complexity of manufacturing our products and may adversely impact the speed and cost of product development efforts. Further, our manufacturing and other business operations and facilities are, or may, become subject to additional federal, state or local laws or regulations relating to supply chain transparency, conflict minerals sourcing and disclosure, end-of-life disposal and recycling requirements and other laws or regulations relating to environmental protection and health and safety requirements. We are not aware of any national or local environmental laws or regulations that may require material capital expenditures or which may materially affect our competitive position or our operational results, financial position or cash flows.

As a retailer, we are subject to additional laws and regulations that apply to retailers generally and govern the marketing and sale of our products and the operation of both our retail stores and our e-commerce activities. Many of the statutory and regulatory requirements which impact our retail and e-commerce operations are consumer-focused and pertain to activities such as the advertising and selling of credit-based promotional offers, truth-in-advertising, privacy, “do not call/mail” requirements, warranty disclosure, delivery timing requirements, accessibility and similar requirements.

All of our operations are or may become subject to federal, state and local labor laws including, but not limited to, those relating to occupational health and safety, employee privacy, wage and hour, overtime pay, harassment and discrimination, equal opportunity and employee leaves and benefits. We are also subject to existing and emerging federal and state laws relating to data security.

It is our policy and practice to comply with all legal and regulatory requirements and our procedures and internal controls are designed to promote such compliance.

Customers

No single customer accounts for 10% or more of our net sales.

Seasonality

Our business is modestly impacted by seasonal influences inherent in the U.S. bedding industry and general retail shopping patterns. The U.S. bedding industry generally experiences lower sales in the second quarter of the calendar year and increased sales during selected holiday or promotional periods.

Working Capital

We are able to operate with minimal working capital requirements because we sell directly to customers, utilize a primarily hybrid "make-to-stock" production process and operate retail stores that serve mainly as showrooms. We have historically generated sufficient cash flows to self-fund operations through an accelerated cash-conversion cycle. In February 2018, we amended our revolving credit facility (Credit Agreement) with a syndicate of banks (Lenders). The Credit Agreement provides a revolving credit facility for general corporate purposes with net aggregate availability of $300 million. The Credit Agreement contains an accordion feature that allows us to increase the amount of the credit facility from $300 million up to $450 million in total availability, subject to Lenders' approval. The Credit Agreement matures in February 2023.

Qualified customers are offered revolving credit to finance purchases through a private-label consumer credit facility provided by Synchrony Bank. Approximately 47% of our net sales in 2017 were financed by Synchrony Bank. Our current agreement with Synchrony Bank expires December 31, 2020, subject to earlier termination upon certain events and subject to automatic extensions. We pay Synchrony Bank a fee for extended credit promotional financing offers. Under the terms of our 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. As the receivables are owned by Synchrony Bank, at no time are the receivables purchased or acquired from us. We are not liable to Synchrony Bank for our customers' credit defaults. In connection with all purchases financed under these arrangements, Synchrony Bank pays us an amount equal to the total amount of such purchases, net of promotional related discounts, upon delivery to the customer. Customers that do not qualify for credit under our agreement with Synchrony Bank may apply for credit under a secondary program that we offer through another provider.

Team Members

At December 30, 2017, we employed 4,099 individuals, including 2,105 retail sales and support team members, 412 customer service team members, 1,080 manufacturing and logistics team members, and 502 management and administrative team members. Approximately 72 of our team members were employed on a part-time or temporary basis at December 30, 2017. Except for managerial team members and professional support staff, all of our team members are paid on an hourly basis (plus commissions for sales professionals). Additionally, we provide various broad-participation incentive compensation programs tied to various performance objectives. None of our team members are represented by a labor union or covered by a collective bargaining agreement. We have a highly engaged team working in a values-driven culture, which we believe is important for an innovation company with such an aspirational vision and life-changing mission.

Executive Officers of the Registrant

SHELLY R. IBACH, 58

President and Chief Executive Officer (Joined the Company in April 2007 and was promoted to President and CEO in June 2012)

Shelly R. Ibach, Sleep Number® setting 40, is the President and Chief Executive Officer (CEO) for Sleep Number (NASDAQ: SNBR). From June 2011 to June 2012, Ms. Ibach served as the company's Executive Vice President and Chief Operating Officer and from October 2008 to June 2011, she served as Executive Vice President, Sales & Merchandising. Ms. Ibach joined the company in April 2007 as Senior Vice President of U.S. sales for company-owned channels. Before joining the company, Ms. Ibach was Senior Vice President and General Merchandise Manager for Macy's home division. From 1982 to 2005, Ms. Ibach held various leadership and executive positions within Target Corporation.

MELISSA BARRA, 46

Senior Vice President, Chief Strategy and Customer Relationship Officer (Joined the Company in 2013 and was promoted to current role in January 2015)

Melissa Barra, Sleep Number® setting 30, serves as the Senior Vice President, Chief Strategy and Customer Relationship Officer. Ms. Barra was Vice President, Consumer Insights and Strategy from February 2013 to January 2015. Prior to joining Sleep Number in February 2013, Ms. Barra was Vice President, Process Reengineering Officer for Best Buy Co., Inc. from 2011 to 2012. In a dual role, she also served as Vice President, Finance, New Business Customer Solutions Group from 2010 to 2012. From 2005 to 2010, she held leadership positions in Strategic Alliances and Corporate Development for Best Buy. Prior to Best Buy, Ms. Barra held corporate finance and strategy leadership roles in companies in the U.S. and internationally, including Grupo Futuro S.A., Citibank and GE Capital.

ANNIE L. BLOOMQUIST, 48

Senior Vice President and Chief Product Officer (Joined the Company in 2008 and was promoted to current role in June 2012)

Annie L. Bloomquist, Sleep Number® setting 25, serves as the Senior Vice President and Chief Product Officer and leads all product innovation, research and development for software and hardware, product brand management, clinical sleep research and merchandising. Ms. Bloomquist was the Chief Product and Merchandising Officer from June 2011 to June 2012. Ms. Bloomquist joined Sleep Number in May 2008 as Vice President and General Merchandise Manager. Prior to joining Sleep Number, Ms. Bloomquist held leadership positions in product and merchandising at Macy's and Marshall Field's Department Stores for Target Corporation.

KEVIN K. BROWN, 49

Senior Vice President and Chief Marketing Officer (Joined the Company in 2013)

Kevin K. Brown, Sleep Number® setting 40, serves as the Senior Vice President and Chief Marketing Officer for Sleep Number. Prior to joining Sleep Number in January 2014, Mr. Brown served as Group Vice President, Chief Marketing Officer for Meijer, Inc., a regional chain of retail supercenters, from 2011 to 2013. From 2007 to 2011, Mr. Brown held executive marketing leadership roles at Sears Holdings Corporation, including Vice President, Chief Marketing Officer for the home appliances business unit. Previously, Mr. Brown held the position of Senior Vice President, Marketing for Jo-Ann Stores, Inc., from 2004 to 2006. Prior to Jo-Ann Stores, he was an associate partner for Accenture.

DAVID R. CALLEN, 51

Senior Vice President and Chief Financial Officer (Joined the Company in 2014)

David R. Callen, Sleep Number® setting 30, serves as the Senior Vice President and Chief Financial Officer for Sleep Number. Prior to joining Sleep Number in April 2014, Mr. Callen served as the Principal Financial Officer, Vice President, Finance and Treasurer for Ethan Allen Interiors, Inc., from 2007 to 2014. Previously, Mr. Callen served for more than 15 years in increasingly responsible international financial management positions, emphasizing brand support and manufacturing across industries including automotive, dental, outdoor recreational products, high tech and public accounting.

ANDY P. CARLIN, 54

Executive Vice President, Chief Sales and Services Officer (Joined the Company in 2008 and was promoted to current role in April 2016)

Andy P. Carlin, Sleep Number® setting 55, serves as the Executive Vice President and Chief Sales and Service Officer for Sleep Number and leads all sales channels, real estate and home delivery operations. From June 2012 to April 2016, Mr. Carlin was Senior Vice President and Chief Sales Officer; from May 2011 to June 2012, Mr. Carlin was the Vice President and Chief Sales Officer; and from January 2009 to May 2011 he was the Vice President of U.S. Retail Sales. Mr. Carlin joined Sleep Number in January 2008 as Regional Vice President, East Region. Prior to joining Sleep Number, Mr. Carlin spent more than 20 years in sales leadership roles for companies including Senior Vice President of Store Operations at Gander Mountain from 2003 to 2008, Kohl's Department Stores from 1995 to 2003 and the department store division of Target Corporation from 1986 to 1995.

PATRICIA A. DIRKS, 61

Senior Vice President and Chief Human Resources Officer (Joined the Company in 2014)

Patricia A. Dirks (Tricia), Sleep Number® setting 30, serves as the Senior Vice President and Chief Human Resources Officer for Sleep Number and leads all human resources functions. Prior to joining Sleep Number in April 2014, Ms. Dirks served as Senior Vice President Organizational Effectiveness for Target Corporation. From 2004 to 2009, Ms. Dirks was Vice President Headquarters Human Resources for Target Corporation. Prior to 2004, Ms. Dirks was Senior Vice President Human Resources at Marshall Field's of Target Corporation.

MARK A. KIMBALL, 59

Senior Vice President and Chief Legal and Risk Officer and Secretary (Joined the Company in 1999)

Mark A. Kimball, Sleep Number® setting 55, serves as Sleep Number's Senior Vice President, Chief Legal and Risk Officer and Secretary. From August 2003 to June 2011, Mr. Kimball held the position of Senior Vice President, General Counsel, Chief Administrative Officer and Secretary. From July 2000 to August 2003, Mr. Kimball served as Senior Vice President, Human Resources and Legal, General Counsel, Chief Administrative Officer and Secretary. From May 1999 to July 2000, Mr. Kimball served as the company's Senior Vice President, Chief Administrative Officer, General Counsel and Secretary. For more than five years prior to joining Sleep Number, Mr. Kimball was a partner in the law firm of Oppenheimer Wolff & Donnelly LLP practicing in the area of corporate finance.

SURESH KRISHNA, 49

Senior Vice President and Chief Operations, Supply Chain and Lean Officer (Joined the Company in 2016)

Suresh Krishna, Sleep Number® setting 40, serves as the Senior Vice President and Chief Operations, Supply Chain and Lean Officer of Sleep Number. Prior to joining Sleep Number, Mr. Krishna joined Polaris in 2010 as Vice President of Global Operations and Integration, leading a 6,500+ person operations organization and driving a culture change to embrace lean across the entire enterprise. In July 2014, he was promoted to Vice President and Business Unit Head of Europe Middle East & Africa (EMEA) for Polaris, where he was responsible for a full P&L with factories, R&D centers, subsidiaries, distributors and dealer networks across more than 60 countries. From 2007 to 2010, he served as Vice President Global Operations, Supply Chain and IT at a division of UTC Fire & Security. Krishna also served in a variety of roles for Diageo, including Vice President of Supply Chain, North America; as a Program Director for an ERP implementation; and as a Director of Strategic Planning and Finance. Earlier in his career he was an associate at Booz Allen & Hamilton.

J. HUNTER SAKLAD, 48

Senior Vice President, Chief Information Officer (Joined the Company in 2004 and was promoted to current role in December 2012)

Hunter Saklad, Sleep Number® setting 50, is the Senior Vice President and Chief Information Officer at Sleep Number. From June 2011 to December 2012, Mr. Saklad served as the Vice President, Consumer Insight and Strategy at Sleep Number. From March 2006 to June 2011 he was Vice President of Finance and held a variety of positions across Finance serving business partners in marketing, sales, supply chain, FP&A, investor relations and treasury. Mr. Saklad joined Sleep Number in October 2004 as Sr. Director of Finance. Prior to joining Sleep Number, Mr. Saklad held finance leadership roles at Ford Motor Company and Visteon.

Available Information

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

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

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

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

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

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

Sleep Number Corporation
Investor Relations Department
1001 Third Avenue South
Minneapolis, MN 55404

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the specific risks set forth below and other matters described in this Annual Report on Form 10-K before making an investment decision. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties, including risks and uncertainties not presently known to us or that we currently see as immaterial, may also harm our business. If any of these risks occur, our business, results of operations, cash flows and financial condition could be materially and adversely affected.

Current and future economic conditions could materially adversely affect our sales, profitability, cash flows and financial condition.

Our success depends significantly upon discretionary consumer spending, which is influenced by a number of general economic factors, including without limitation economic growth, consumer confidence, the housing market, employment and income levels, interest rates, inflation, taxation and the level of customer traffic in malls and shopping centers. Adverse trends in any of these economic factors may adversely affect our sales, profitability, cash flows and financial condition.

Our future growth and profitability depends upon the effectiveness and efficiency of our marketing programs.

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. We continue to evolve our marketing strategies, adjusting our messages, the amount we spend on advertising and where we spend it. We may not always be successful in developing effective messages, as the consumer and competition changes, and in achieving efficiency in our advertising expenditures.

Consumers are increasingly using digital tools as a part of their shopping experience. As a result, our future growth and profitability will depend in part on (i) the effectiveness and efficiency of our on-line experience, including without limitation advertising and search optimization programs, in generating consumer awareness and sales of our products, (ii) our ability to prevent confusion among consumers that can result from search engines that allow competitors to use or bid on our trademarks to direct consumers to competitors' websites, (iii) our ability to prevent Internet publication of false or misleading information regarding our products or our competitors' products; (iv) the nature and tone of consumer sentiment published on various social media sites; and (v) the stability of our website. In recent periods, competitor spending on Internet-based marketing programs has increased, including without limitation from a number of direct-to-consumer, Internet-based retailers, which has and may continue to increase the cost of basic search terms and the cost of our Internet-based marketing programs.

If our marketing messages are ineffective or our advertising expenditures and other marketing programs, including digital programs, are inefficient in creating awareness and consideration of our products and brand name, and in driving consumer traffic to our website or stores, our sales, profitability, cash flows and financial condition may be adversely impacted. In addition, if we are not effective in preventing the publication of confusing, false or misleading information regarding our brand or our products, or if there is significant negative consumer sentiment on social media regarding our brand or our products, our sales, profitability, cash flows and financial condition may be adversely impacted.

Our future growth and profitability depends on our ability to execute our Company-Controlled distribution strategy.

The vast majority of our sales occur through our Company-Controlled distribution channel, including our retail stores, and this Company-Controlled distribution channel represents our largest opportunity for growth in sales and improvement in profitability. Our retail stores carry significant fixed costs. We also make significant capital expenditures as we open new stores and remodel or reposition existing stores. We are highly dependent on our ability to maintain and increase sales per store to cover these fixed expenses, provide a return on our capital investments and improve our operating margins.

Many of our stores are mall-based. We depend on the continued popularity of malls as shopping destinations and the ability of mall anchor tenants and other attractions to generate customer traffic for our mall-based retail stores. Any decrease in mall traffic could adversely affect our sales, profitability, cash flows and financial condition.

Our Company-Controlled distribution strategy results in relatively few points of distribution, including 556 retail stores in 50 U.S. states as of the end of 2017. Several of the mattress manufacturers and retailers with which we compete have significantly more points of distribution than we do, which makes us highly dependent on our ability to drive consumers to our points of distribution to gain market share.

Our longer term Company-Controlled distribution strategy is also dependent on our ability to renew existing store leases and to secure suitable locations for new store openings, in each case on a cost-effective basis. We may encounter higher than anticipated rents and other costs in connection with managing our retail store base, or may be unable to find or obtain suitable new locations.

Failure to achieve and maintain a high level of product quality could negatively impact our sales, profitability, cash flows and financial condition.

Our products are highly differentiated from traditional innerspring mattresses and from viscoelastic and other foam mattresses, which have little or no technology and do not rely on electronics and air control systems. As a result, our beds may be susceptible to failures that do not exist with traditional or foam mattresses. Failure to achieve and maintain acceptable quality standards could impact consumer acceptance of our products or could result in negative media and Internet reports or owner dissatisfaction that could negatively impact our brand image and sales levels.

In addition, a decline in product quality could result in an increase in return rates and a corresponding decrease in sales, or an increase in product warranty claims in excess of our warranty reserves. An unexpected increase in return rates or warranty claims could harm our sales, profitability, cash flows and financial condition.

As a consumer innovation company with differentiated products, we face an inherent risk of exposure to product liability claims if the use of our products is alleged to have resulted in personal injury or property damage. If any of our products proves to be defective, we may be required to recall or redesign such products. We have at times experienced increased returns and adverse impacts on sales, as well as product liability litigation, as a result of media reports related to the alleged propensity of our products to develop mold. We may experience additional adverse impacts on sales and additional litigation if any similar media reports were to occur in the future. We maintain insurance against some forms of product liability claims, but such coverage may not be adequate for liabilities actually incurred. A successful claim brought against us in excess of available insurance coverage, or any claim or product recall that results in significant adverse publicity against us, may have a material adverse effect on our sales, profitability, cash flows and financial condition.

Our future growth and profitability depends in part on our ability to continue to improve and expand our product line and to successfully execute new product introductions.

As described in greater detail below, the mattress industry, as well as the market for sleep monitoring products, are both highly competitive, and our ability to compete effectively and to profitably grow our market share depends in part on our ability to continue to improve and expand our product line of adjustable firmness air beds, SleepIQ technology and related accessory products. We incur significant research and development and other expenditures in the pursuit of improvements and additions to our product line. If these efforts do not result in meaningful product improvements or new product introductions, or if we are not able to gain widespread consumer acceptance of product improvements or new product introductions, our sales, profitability, cash flows and financial condition may be adversely affected. In addition, if any significant product improvements or new product introductions are not successful, our reputation and brand image may be adversely affected.

In 2017, we began to introduce a new line of mattresses to replace our prior line of mattresses, and this new product introduction will continue in 2018 as we plan to convert the remainder of our product line. This new product launch requires significant transition costs in our supply chain and retail stores. If we are not able to gain widespread consumer acceptance of this new product line, or if we do not successfully execute the new product introduction effectively and efficiently, our sales, profitability, cash flows and financial condition may be adversely affected.

Significant competition could adversely affect our business.

Because of the vertical integration of our business model, our products and distribution channels face significant competition from both manufacturers of different types of mattresses and a variety of retailers. Our SleepIQ technology also faces significant competition from various manufacturers and retailers of sleep tracking and monitoring products.

The mattress industry is characterized by a high degree of concentration among the largest manufacturers of innerspring mattresses and foam mattresses and one dominant national mattress retailer. Many newer competitors in the mattress industry have begun to offer "bed-in-a-box" or similar products directly to consumers through the Internet and other distribution channels.

A variety of sleep tracking and monitoring products that compete with our SleepIQ technology have been introduced by various manufacturers and retailers, both within and outside of the traditional mattress industry.

Some of the manufacturers that we compete with have substantially greater financial, marketing and manufacturing resources and greater brand name recognition than we do and sell products through broader and more established distribution channels. Our national, exclusive distribution competes with other retailers who generally provide a wider selection of mattress alternatives than we offer. A number of these retailers also have more points of distribution and greater brand name recognition than we do.

These manufacturing and retailing competitors, or new entrants into the market, may compete aggressively and gain market share with existing or new products, and may pursue or expand their presence in the adjustable firmness air bed segment of the market as well as in the market for sleep tracking and monitoring products. We have limited ability to anticipate the timing and scale of new product introductions, advertising campaigns or new pricing strategies by our competitors, which could inhibit our ability to retain or increase market share, or to maintain our product margins.

If we are unable to effectively compete with other manufacturers and retailers of mattress and sleep tracking and monitoring products, our sales, profitability, cash flows and financial condition may be adversely impacted.

Our intellectual property rights may not prevent others from using our technology or trademarks in connection with the sale of competitive products. We may be subject to claims that our products, processes or trademarks infringe intellectual property rights of others.

We own various U.S. and foreign patents and patent applications related to certain elements of the design and function of our beds and related products. We own numerous registered and unregistered trademarks and trademark applications, including in particular our *Sleep Number* and *SleepIQ* trademarks, as well as other intellectual property rights, including trade secrets, trade dress and copyrights, which we believe have significant value and are important to the marketing of our products. These intellectual property rights may not provide sufficient protection against infringement or piracy, may not prevent competitors from developing and marketing products that are similar to or competitive with our beds or other products, and may be costly and time-consuming to protect and enforce. Our patents are also subject to varying expiration dates. In addition, the laws of some foreign countries may not protect our intellectual property rights and confidential information to the same extent as the laws of the United States. If we are unable to protect and enforce our intellectual property, we may be unable to prevent other companies from using our technology or trademarks in connection with competitive products, which could adversely affect our sales, profitability, cash flows and financial condition.

We may be subject to claims that our products, processes or trademarks infringe the intellectual property rights of others. The defense of these claims, even if we are ultimately successful, may result in costly litigation, and if we are not successful in our defense, we could be subject to injunctions, liability for damages or royalty obligations and our sales, profitability, cash flows and financial condition could be adversely affected.

A reduction in the availability of credit to consumers generally or under our existing consumer credit programs could harm our sales, profitability, cash flows and financial condition.

A significant percentage of our sales are made under consumer credit programs through third parties. The amount of credit available to consumers may be adversely impacted by macroeconomic factors that affect the financial position of consumers and as suppliers of credit adjust their lending criteria. In addition, changes in federal regulations effective in 2010 placed additional restrictions on all consumer credit programs, including limiting the types of promotional credit offerings that may be offered to consumers.

Synchrony Bank provides credit to our customers through a private label credit card agreement that is currently scheduled to expire on December 31, 2020, subject to earlier termination upon certain events. Synchrony Bank has discretion to control the content of financing offers to our customers and to set minimum credit standards under which credit is extended to customers.

Reduction of credit availability due to changing economic conditions, changes in credit standards under our private label credit card program or changes in regulatory requirements, or the termination of our agreement with Synchrony Bank, could harm our sales, profitability, cash flows and financial condition.

We could be vulnerable to shortages in supply of components necessary to manufacture our products due to our manufacturing processes with minimal levels of inventory or due to global shortages of supply of electronic componentry, which may harm our ability to satisfy consumer demand and may adversely impact our sales and profitability.

A significant percentage of our products are assembled after we receive orders from customers utilizing manufacturing processes with minimal levels of raw materials, work-in-process inventories and finished goods inventories. Lead times for ordered components may vary significantly, and some components used to manufacture our products are provided on a sole source basis. In addition, with the increasing prevalence of and consumer demand for electronic products, the global supply of electronic componentry is increasingly strained, which may lead to shortages in supply and increased prices. Any unexpected shortage of materials caused by any disruption or unavailability of supply or an unexpected increase in the demand for our products, could lead to delays in shipping our beds to customers and increased costs. Any such delays could adversely affect our sales, customer satisfaction, profitability, cash flows and financial condition.

We rely upon several key suppliers that are, in some instances, the only source of supply currently used by us for particular materials, components or services. A disruption in the supply or substantial increase in cost of any of these products or services could harm our sales, profitability, cash flows and financial condition.

We currently obtain all of the materials and components used to produce our beds from outside sources including some who are located outside the United States. In several cases, including our proprietary air chambers, our proprietary blow-molded foundations, our adjustable foundations, various components for our Firmness Control systems, certain foam formulations, as well as fabrics and zippers, we have chosen to obtain these materials and components from suppliers who serve as the only source of supply, or who supply the vast majority of our needs of the particular material or component. While we believe that these materials and components, or suitable replacements, could be obtained from other sources, in the event of a disruption or loss of supply of relevant materials or components for any reason, we may not be able to find alternative sources of supply, or if found, may not be found on comparable terms. If our relationship with the primary supplier of our air chambers or the supplier of our adjustable foundations is terminated, we could have difficulty in replacing these sources since there are relatively few other suppliers presently capable of manufacturing these components.

Similarly, we rely on UPS and other carriers to deliver some of our products to customers on a timely and cost-effective basis. Any significant delay in deliveries to our customers could lead to increased returns and cause us to lose sales. Any increase in freight charges could increase our costs of doing business and harm our sales, profitability, cash flows and financial condition.

Fluctuations in commodity prices could result in an increase in component costs and/or delivery costs.

Our business is subject to significant increases or volatility in the prices of certain commodities, including but not limited to electronic componentry, fuel, oil, natural gas, rubber, cotton, plastic resin, steel and chemical ingredients used to produce foam. Increases in prices of these commodities or other inflationary pressures may result in significant cost increases for our raw materials and product components, as well as increases in the cost of delivering our products to our customers. To the extent we are unable to offset any such increased costs through value engineering and similar initiatives, or through price increases, our profitability, cash flows and financial condition may be adversely impacted. If we choose to increase prices to offset the increased costs, our sales volumes could be adversely impacted.

Our business is subject to risks inherent in global sourcing activities.

Our air chambers and some of our other components are manufactured outside the United States, and therefore are subject to risks associated with foreign sourcing of materials, including but not limited to:

- Political instability resulting in disruption of trade;
- Existing or potential duties, tariffs or quotas on certain types of goods that may be imported into the United States;
- Disruptions in transportation due to acts of terrorism, shipping delays, foreign or domestic dock strikes, customs inspections or other factors;
- Foreign currency fluctuations; and
- Economic uncertainties, including inflation.

These factors could increase our costs of doing business with foreign suppliers, lead to inadequate inventory levels or delays in shipping beds to our customers, which could harm our sales, customer satisfaction, profitability, cash flows and financial condition.

Disruption of operations in either of our two main manufacturing facilities could increase our costs of doing business or lead to delays in shipping our beds.

We have two main manufacturing plants, which are located in Irmo, South Carolina and Salt Lake City, Utah. A significant percentage of our products are assembled to fulfill orders rather than stocking finished goods inventory in our plants or stores. Therefore, the disruption of operations of either of our two main manufacturing facilities for a significant period of time may increase our costs of doing business and lead to delays in shipping our beds to customers. Such delays could adversely affect our sales, customer satisfaction, profitability, cash flows and financial condition.

Our business is subject to a wide variety of government laws and regulations. These laws and regulations, as well as any new or changed laws or regulations, could disrupt our operations or increase our compliance costs. Failure to comply with such laws and regulations could have further adverse impact.

We are subject to a wide variety of laws and regulations relating to the bedding industry or to various aspects of our business. Laws and regulations at the federal, state and local levels frequently change and we cannot always reasonably predict the impact from, or the ultimate cost of compliance with, future regulatory or administrative changes. Changes in law, the imposition of new or additional regulations or the enactment of any new or more stringent legislation that impacts employment and labor, trade, advertising and marketing practices, pricing, consumer credit offerings, product testing and safety, transportation and logistics, health care, tax, accounting, privacy and data security, health and safety or environmental issues, among others, could require us to change the way we do business and could have a material adverse impact on our sales, profitability, cash flows and financial condition. New or different laws or regulations could increase direct compliance costs for us or may cause our vendors to raise the prices they charge us because of increased compliance costs. Further, the adoption of a multi-layered regulatory approach to any one of the state or federal laws or regulations to which we are currently subject, particularly where the layers are in conflict, could require alteration of our manufacturing processes or operational parameters which may adversely impact our business.

Legislative or regulatory changes that impact our relationship with our workforce, such as minimum wage requirements or health insurance or other employee benefits mandates, could increase our expenses and adversely affect our operations. While it is our policy and practice to comply with legal and regulatory requirements and our procedures and internal controls are designed to promote such compliance, we cannot assure that all of our operations will comply with all such legal and regulatory requirements. Further, laws and regulations change over time and we may be required to incur significant expenses and/or to modify our operations in order to ensure compliance. This could harm our profitability or financial condition. If we are found to be in violation of any laws or regulations, we could become subject to fines, penalties, damages or other sanctions as well as potential adverse publicity or litigation exposure. This could adversely impact our business, reputation, sales, profitability, cash flows or financial condition.

Regulatory requirements related to flammability standards for mattresses may increase our product costs and increase the risk of disruption to our business.

The federal Consumer Product Safety Commission adopted new flammability standards and related regulations which became effective nationwide in July 2007 for mattresses and mattress and foundation sets. Compliance with these requirements has resulted in higher materials and manufacturing costs for our products, and has required modifications to our information systems and business operations, further increasing our costs and negatively impacting our capacity.

These regulations require manufacturers to implement quality assurance programs and encourage manufacturers to conduct random testing of products. These regulations also require maintenance and retention of compliance documentation. These quality assurance and documentation requirements are costly to implement and maintain. If any product testing, other evidence, or regulatory inspections yield results indicating that any of our products may not meet the flammability standards, we may be required to temporarily cease production and distribution and/or to recall products from the field, and we may be subject to fines or penalties, any of which outcomes could harm our business, reputation, sales, profitability, cash flows and financial condition.

Pending or unforeseen litigation and the potential for adverse publicity associated with litigation could adversely impact our business, reputation, financial results or financial condition.

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. We currently do not expect the outcome of any pending matters 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 pending claims asserted against us, or claims that may be asserted in the future that we are currently not aware of, or adverse publicity resulting from any such litigation, could adversely impact our business, reputation, sales, profitability, cash flows and financial condition.

Any improvements or upgrades to our management information systems that may be required to meet the evolving needs of our business as well as existing and emerging regulatory requirements may be costly to implement and may take longer or require greater resources than anticipated, and may result in disruptions to our systems or business.

We depend on our management information systems for many aspects of our business. In the fourth quarter of 2015, we implemented a new ERP system and continue to implement operational improvements under this new system. If our new systems are disrupted in any material way, or improvements or upgrades are required to meet the evolving needs of our business and existing and emerging regulatory requirements, we may be required to incur significant capital expenditures in the pursuit of improvements or upgrades to our management information systems. These efforts may take longer and may require greater financial and other resources than anticipated, may cause distraction of key personnel, and may cause short-term disruptions to our existing systems and our business. Any of these outcomes could impair our ability to achieve critical strategic initiatives and could adversely impact our sales, profitability, cash flows and financial condition.

Our information systems may be subject to attacks by hackers or other cyber threats that could compromise the security of our systems, which could substantially disrupt our business and could result in the breach of consumers' or employees' private data.

Our information systems contain personal information related to our customers and employees in the ordinary course of our business, such as credit card and demographic information of our customers, SleepIQ data from our customer base and social security numbers and demographic information of our employees. While we maintain security measures to protect this information, a breach of these security measures, such as through third-party action, employee error, malfeasance or otherwise, could compromise the security of our customers' and employees' personal information. As the techniques used to breach such security measures change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. Any failure of our systems and processes to adequately protect customer or employee personal information from theft or loss could adversely impact our business, reputation, sales, profitability, cash flows and financial condition.

Our future growth and profitability depends in part upon our ability to attract, retain and motivate qualified personnel.

As a vertically integrated manufacturer and retailer, our future growth and profitability will depend in part upon our ability to attract, retain and motivate qualified personnel in a wide variety of areas to execute our growth strategy, including qualified management and executive personnel and qualified retail sales professionals and managers. The failure to attract, retain and motivate qualified personnel may hinder our ability to execute our business strategy and growth initiatives and may adversely impact our sales, profitability, cash flows and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Retail Locations

We currently lease all of our existing retail store locations and expect that our policy of leasing stores, rather than owning stores, will continue. We lease our retail stores 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. Our retail store leases generally provide for an initial lease term of five to 10 years. In addition, our mall-based retail store leases may require payment of contingent rent based on net sales in excess of certain thresholds. Certain retail store leases may contain options to extend the term of the original lease.

The following table summarizes the geographic locations of our 556 retail stores as of December 30, 2017:

	Retail Stores		Retail Stores		Retail Stores
Alabama	8	Louisiana	8	Ohio	19
Alaska	1	Maine	2	Oklahoma	4
Arizona	10	Maryland	13	Oregon	6
Arkansas	4	Massachusetts	11	Pennsylvania	20
California	67	Michigan	18	Rhode Island	1
Colorado	14	Minnesota	15	South Carolina	8
Connecticut	6	Mississippi	5	South Dakota	2
Delaware	2	Missouri	13	Tennessee	11
Florida	39	Montana	4	Texas	51
Georgia	20	Nebraska	3	Utah	6
Hawaii	1	Nevada	5	Vermont	1
Idaho	3	New Hampshire	4	Virginia	17
Illinois	21	New Jersey	14	Washington	13
Indiana	10	New Mexico	3	West Virginia	2
Iowa	8	New York	17	Wisconsin	11
Kansas	7	North Carolina	15	Wyoming	1
Kentucky	8	North Dakota	4	Total	556

Manufacturing, Distribution and Headquarters

We lease our 238,000 square-foot corporate headquarters in Minneapolis, Minnesota. The lease term commenced in November 2017 and runs through October 2032. The lease includes three five-year renewal options.

We lease two manufacturing and distribution centers in Irmo, South Carolina and Salt Lake City, Utah of approximately 151,000 square feet and approximately 101,000 square feet, respectively. The Irmo facility lease runs through June 2026, with two five-year renewal options. The Salt Lake City facility lease runs through July 2020, with two five-year renewal options. We also lease one storage facility in Salt Lake City of approximately 57,000 square feet through April 2020, and a second storage facility in Salt Lake City of approximately 80,000 square feet through November 2019.

We lease a bedding collection and fulfillment center in Brooklyn Park, Minnesota consisting of approximately 60,000 square feet. This lease runs through July 2020, with two three-year renewal options.

We lease a call center in Jefferson, Louisiana consisting of approximately 28,000 square feet. This lease runs through August 2022, with two three-year renewal options.

We lease one facility for our SleepIQ LABS operations in San Jose, California of approximately 13,000 square feet which runs through August 2018 and contains one three-year renewal option.

We lease approximately 900 square feet of office space in Portland, Oregon, which runs through September 2019.

ITEM 3. 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 generally accepted accounting principles in the United States, 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. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible additional losses either because we believe that we have valid defenses to claims asserted against us or the proceeding has not advanced to a stage of discovery that would enable us to establish an estimate. We currently do not expect the outcome of these matters 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 January 12, 2015, Plaintiffs David and Katina Spade commenced a purported class action lawsuit in New Jersey state court against Sleep Number alleging that Sleep Number violated New Jersey consumer statutes by failing to provide to purchasing consumers certain disclosures required by the New Jersey Furniture Regulations. It is undisputed that plaintiffs suffered no actual damages or in any way relied upon or were impacted by the alleged omissions. Nonetheless, on behalf of a purported class of New Jersey purchasers of Sleep Number beds and bases, plaintiffs seek to recover a $100 statutory fine for each alleged omission, along with attorneys' fees and costs. Sleep Number removed the case to the United States District Court for the District of New Jersey, which subsequently granted Sleep Number's motion to dismiss. Plaintiffs appealed to the United States Court of Appeals for the Third Circuit, which has certified two questions of law to the New Jersey Supreme Court relating to whether plaintiffs who have suffered no actual injury may bring claims. The New Jersey Supreme Court has accepted the certified questions and oral arguments were heard in November 2017. As the United States District Court for the District of New Jersey determined, we believe that the case is without merit and the order of dismissal should be affirmed.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Our common stock trades on The NASDAQ Stock Market LLC (NASDAQ Global Select Market) under the symbol "SNBR." As of January 26, 2018, there were approximately 220 holders of record of our common stock. The following table sets forth the quarterly high and low sales prices per share of our common stock, at closing, as reported by NASDAQ for the two most recent fiscal years.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal 2017				
High	$ 24.79	$ 35.60	$ 34.97	$ 38.00
Low	19.53	24.49	28.49	29.84
Fiscal 2016				
High	$ 21.24	$ 24.68	$ 27.68	$ 24.33
Low	15.58	19.17	21.31	18.55

We are not restricted from paying cash dividends under our credit agreement so long as we are not in default under the credit agreement and so long as the payment of such dividends would not create an event of default. However, we have not historically paid, and have no current plans to pay, cash dividends on our common stock.

Information concerning share repurchases completed during the fourth quarter of fiscal 2017 is set forth below:

Fiscal 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)
October 1, 2017 through October 28, 2017	241,934	$ 32.21	240,530	$ 492,252,000
October 29, 2017 through November 25, 2017	349,171	32.18	348,429	481,041,000
November 26, 2017 through December 30, 2017	432,649	37.12	432,173	465,000,000
Total	1,023,754	$ 34.27	1,021,132	$ 465,000,000

(1) Under our Board-approved $500 million share repurchase program, we repurchased 1,021,132 shares of our common stock at a cost of $35 million (based on trade dates) during the three months ended December 30, 2017.

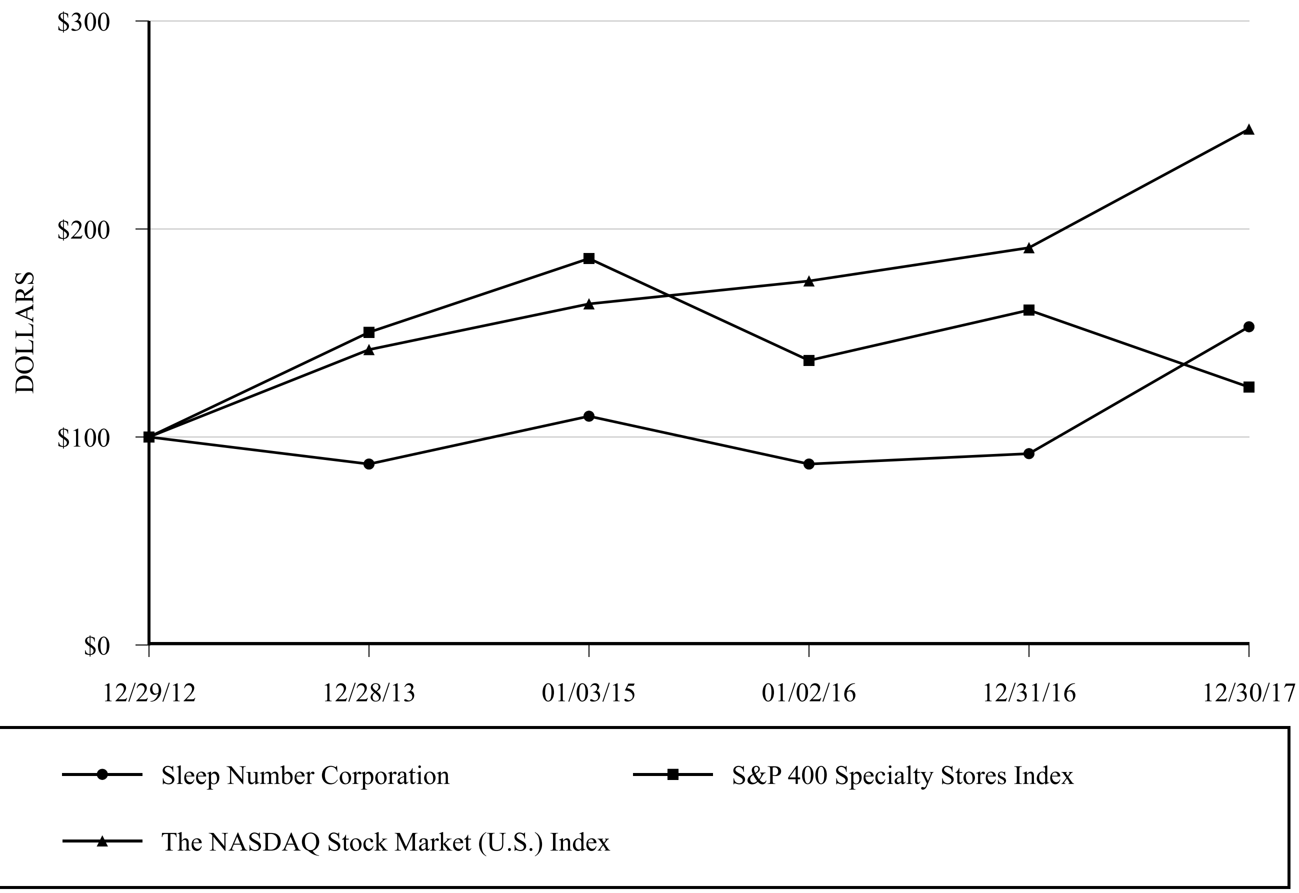
(2) In connection with the vesting of employee restricted stock grants, we also repurchased 2,622 shares of our common stock at a cost of $87,000 during the three months ended December 30, 2017.

(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.

Comparative Stock Performance

The graph below compares the total cumulative shareholder return on our common stock over the last five years to the total cumulative return on the Standard and Poor's (S&P) 400 Specialty Stores Index and The NASDAQ Stock Market (U.S.) Index assuming a $100 investment made on December 29, 2012. Each of the three measures of cumulative total return assumes reinvestment of dividends. The stock performance shown on the graph below is not necessarily indicative of future price performance. The information contained in this "Comparative Stock Performance" section shall not be deemed to be "soliciting material" or "filed" or incorporated by reference in future filings with the SEC, or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended, except to the extent that we specifically request that it be treated as soliciting material or incorporate it by reference into a document filed under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

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



	12/29/2012	12/28/2013	1/3/2015	1/2/2016	12/31/2016	12/30/2017
Sleep Number Corporation	$ 100	$ 87	$ 110	$ 87	$ 92	$ 153
S&P 400 Specialty Stores Index	100	150	186	137	161	124
The NASDAQ Stock Market (U.S.) Index	100	142	164	175	191	248

ITEM 6. SELECTED FINANCIAL DATA

(in thousands, except per share and selected operating data, unless otherwise indicated)

The Consolidated Statements of Operations Data and Consolidated Balance Sheet Data presented below have been derived from our Consolidated Financial Statements and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Consolidated Financial Statements and Notes thereto included in this Annual Report on Form 10-K.

	Year				
	2017	2016	2015	2014[1]	2013
Consolidated Statements of Operations Data:					
Net sales	$ 1,444,497	$ 1,311,291	$ 1,213,699	$ 1,156,757	$960,171
Gross profit	897,347	810,160	740,751	706,850	601,755
Operating expenses:					
Sales and marketing	650,357	595,845	550,475	512,007	439,156
General and administrative	127,269	109,674	99,209	84,864	62,433
Research and development	27,806	27,991	15,971	8,233	9,478
Operating income	91,915	76,650	75,096	101,746	90,688
Net income	$ 65,077	$ 51,417	$ 50,519	$ 67,974	$ 60,081
Net income per share:					
Basic	$ 1.58	$ 1.11	$ 0.99	$ 1.27	$ 1.10
Diluted	$ 1.55	$ 1.10	$ 0.97	$ 1.25	$ 1.08
Shares used in calculation of net income per share:					
Basic	41,212	46,154	51,252	53,452	54,866
Diluted	42,085	46,902	52,101	54,193	55,803
Consolidated Balance Sheet Data:					
Cash, cash equivalents and marketable debt securities	$ 3,651	$ 11,609	$ 36,114	$ 166,045	$145,014
Total assets	471,834	457,166	500,897	474,187	381,765
Total shareholders' equity	89,156	160,320	222,339	256,907	225,220
Selected Operating Data:					
Stores open at period-end	556	540	488	463	440
Stores opened during period	36	72	38	57	71
Stores closed during period	20	20	13	34	41
Average revenue per store (000's)[2]	$ 2,420	$ 2,364	$ 2,377	$ 2,327	$ 2,093
Percentage of stores with more than $1.0 million in net sales[2]	98%	98%	99%	98%	96 %
Percentage of stores with more than $2.0 million in net sales[2]	61%	61%	62%	59%	46 %
Average revenue per mattress unit - Company-Controlled channel[3]	$ 4,283	$ 4,046	$ 4,028	$ 3,671	$ 3,245
Company-Controlled comparable-sales increase (decrease)[4]	4%	1%	3%	12%	(4)%
Total retail square footage (at period-end) (000's)	1,489	1,399	1,214	1,106	949
Average square footage per store open during period[2]	2,647	2,538	2,445	2,302	1,985
Net sales per square foot[2]	$ 920	$ 937	$ 980	$ 1,025	$ 1,077
Average store age (in months at period-end)	97	93	99	97	102
Earnings before interest, depreciation and amortization (Adjusted EBITDA)[5]	$ 169,097	$ 145,689	$ 133,057	$ 148,223	$125,020
Free cash flows[5]	$ 112,778	$ 93,793	$ 22,356	$ 67,874	$ 11,294
Return on invested capital (ROIC)[5]	14.3%	12.2%	11.2%	15.1%	15.1 %

(1) Fiscal year 2014 had 53 weeks. All other fiscal years presented had 52 weeks.

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

(3) Represents Company-Controlled channel total net sales divided by Company-Controlled channel mattress units.

(4) Stores are included in the comparable sales calculation in the 13th full month of operation. Stores that have been remodeled or repositioned within the same shopping center remain in the comparable-store base. The number of comparable stores used to calculate such data was 512, 459, 442, 396 and 359 for 2017, 2016, 2015, 2014 and 2013, respectively. Fiscal 2014 included 53 weeks, as compared to 52 weeks for the other periods presented. Comparable sales have been adjusted and reported as if all years had the same number of weeks.

(5) These non-GAAP measures are not in accordance with, or preferable to, GAAP financial data. However, we are providing this information as we believe it facilitates annual and year-over-year comparisons for investors and financial analysts. See pages 23 and 24 for the reconciliation of these non-GAAP measures to the appropriate GAAP measures.

Non-GAAP Data Reconciliations

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

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:

	Year				
	2017	**2016**	**2015**	**2014**	**2013**
Net income	$ 65,077	$ 51,417	$ 50,519	$ 67,974	$ 60,081
Income tax expense	25,961	24,516	24,911	34,134	30,930
Interest expense	975	811	160	53	51
Depreciation and amortization	61,077	56,910	46,916	38,767	29,599
Stock-based compensation	15,763	11,961	10,290	6,798	4,232
Asset impairments	244	74	261	497	127
Adjusted EBITDA	$ 169,097	$ 145,689	$ 133,057	$ 148,223	$ 125,020

Free Cash Flow
(in thousands)

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 operations," or GAAP financial data. However, we are providing this information as we believe it facilitates analysis for investors and financial analysts.

	Year				
	2017	**2016**	**2015**	**2014**	**2013**
Net cash provided by operating activities	$ 172,607	$ 151,645	$ 107,942	$ 144,468	$ 88,105
Less: Purchases of property and equipment	(59,829)	(57,852)	(85,586)	(76,594)	(76,811)
Free cash flow	$ 112,778	$ 93,793	$ 22,356	$ 67,874	$ 11,294

Non-GAAP Data Reconciliations (continued)

Return on Invested Capital (ROIC)
(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:

	Year				
	2017	2016	2015	2014	2013
Net operating profit after taxes (NOPAT)					
Operating income	$ 91,915	$ 76,650	$ 75,096	$ 101,746	$ 90,688
Add: Rent expense[1]	74,019	67,416	62,369	57,605	50,289
Add: Interest income	97	94	494	415	375
Less: Depreciation on capitalized operating leases[2]	(18,865)	(17,185)	(16,203)	(14,265)	(13,095)
Less: Income taxes[3]	(48,970)	(41,933)	(40,384)	(48,900)	(43,827)
NOPAT	$ 98,196	$ 85,042	$ 81,372	$ 96,601	$ 84,430
Average invested capital					
Total equity	$ 89,156	$ 160,320	$ 222,339	$ 256,907	$ 225,220
Less: Cash greater than target[4]	—	—	—	(37,319)	(29,622)
Add: Long-term debt[5]	—	—	—	—	2
Add: Capitalized operating lease obligations[6]	592,152	539,328	498,952	460,840	402,312
Total invested capital at end of period	$ 681,308	$ 699,648	$ 721,291	$ 680,428	$ 597,912
Average invested capital[7]	$ 686,436	$ 699,576	$ 726,756	$ 639,118	$ 560,133
Return on invested capital (ROIC)[8]	14.3%	12.2%	11.2%	15.1%	15.1%

(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 6) for the respective reporting periods with an assumed thirty-year useful life. 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 33.3%, 33.0%, 33.2%, 33.6% and 34.2% for 2017, 2016, 2015, 2014 and 2013, respectively.

(4) Cash greater than target is defined as cash, cash equivalents and marketable debt securities less customer prepayments in excess of $100 million.

(5) Long-term debt includes capital lease obligations, if applicable.

(6) 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.

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

(8) 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.

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

Forward-Looking Statements

The discussion in this Annual Report contains certain forward-looking statements that relate to future plans, events, financial results or performance. You can identify forward-looking statements by those that are not historical in nature, particularly those that use terminology such as "may," "will," "should," "could," "expect," "anticipate," "believe," "estimate," "plan," "project," "predict," "intend," "potential," "continue" or the negative of these or similar terms. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. These risks and uncertainties include, among others:

- *Current and future general and industry economic trends and consumer confidence;*
- *The effectiveness of our marketing messages;*
- *The efficiency of our advertising and promotional efforts;*
- *Our ability to execute our Company-Controlled 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;*
- *The potential for claims that our products, processes 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 our ability to maintain relationships with key suppliers, including several sole-source suppliers;*
- *Rising commodity costs and other inflationary pressures;*
- *Risks inherent in global sourcing activities, including the potential for shortages in supply;*
- *Risks of disruption in the operation of either of our two main manufacturing facilities;*
- *Increasing government regulation;*
- *Pending or unforeseen litigation and the potential for adverse publicity associated with litigation;*
- *The adequacy of our management 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 management information systems;*
- *The vulnerability of our management information systems to attacks by hackers or other cyber threats that could compromise the security of our systems or disrupt our business;*
- *Our ability to attract, retain and motivate qualified management, executive and other key employees, including qualified retail sales professionals and managers.*

Additional information concerning these and other risks and uncertainties is contained under the caption "Risk Factors" in this Annual Report on Form 10-K.

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide a reader of our 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 six sections:

- Overview
- Results of Operations
- Liquidity and Capital Resources
- Off-Balance-Sheet Arrangements and Contractual Obligations
- Critical Accounting Policies and Estimates
- Recent Accounting Pronouncements

Overview

Business Overview

Our mission is to improve lives by individualizing sleep experiences. Our vision is to become one of the world's most beloved brands by delivering an unparalleled sleep experience. We plan to achieve this by strengthening our three significant competitive advantages: proprietary sleep innovations, lifelong customer relationships and exclusive retail distribution.

We have a vertically integrated business model and are the exclusive designer, manufacturer, marketer, retailer and servicer of Sleep Number beds. We offer consumers high-quality, individualized sleep solutions and services, including a complete line of Sleep Number beds, bases and bedding accessories. We are the pioneer in biometric sleep tracking and adjustability. Only the Sleep Number bed offers SleepIQ technology - a proprietary sensor technology that tracks each individual's sleep and works directly with the bed's DualAir system to automatically adjust the comfort level of each sleeper. Through daily digital interactions that build lifelong relationships, SleepIQ technology also communicates how you slept and provides insights on what adjustments you can make to optimize your sleep and improve your daily life. Sleep Number also offers FlextFit adjustable bases, and Sleep Number pillows, sheets and other bedding products. As a national specialty mattress retailer, we offer consumers a cohesive experience across our Sleep Number stores, online at SleepNumber.com or via phone at (800)753-3768.

We are committed to delivering superior shareholder value through three primary drivers of earnings per share growth: increasing consumer demand, leveraging our business model and deploying capital efficiently. We are the sleep innovation leader and drive growth through effective brand marketing and a differentiated retail experience.

We generate revenue by marketing our innovations to new and existing customers, and selling products through two distribution channels. Our Company-Controlled channel, which includes Retail, Online and Phone, sells directly to consumers. Our Wholesale/Other channel sells to and through selected retail and wholesale customers in the United States.

We are also the only vertically integrated bed manufacturer/retailer in the U.S. We have two manufacturing plants that distribute Sleep Number products. We also offer mattress home delivery and installation, and maintain an in-house customer service department. This integration enables operational synergies and efficiencies, and a strong working capital position. Vertical integration allows us to build a long-term loyal customer relationship as we service the consumer through the full purchase and ownership cycle. This relationship with our customer creates a productive cycle of repeat and referral business.

Results of Operations

Fiscal 2017 Summary

Financial highlights for fiscal 2017 were as follows:

- Net sales for 2017 increased 10% to $1.44 billion, compared with $1.31 billion in the prior year. Company-Controlled comparable sales increased 4% and sales from 16 net new stores opened in the past 12 months added 7 percentage points (ppt.) of growth in 2017.
- In May 2017, we began selling our Sleep Number 360™ i7 and i10 smart beds. The Sleep Number 360 smart bed won 13 awards at CES, including being named the Best of Innovation Honoree in the Home Appliance category. We launched our third smart bed model (the p6) in December 2017, and remain on track to complete the phased implementation of our 360 smart bed line by mid-year 2018.
- On a trailing twelve-month basis, sales per store (for stores open at least one year) of $2.4 million increased 2% from the comparable period one-year ago.
- Operating income for 2017 increased 20% to $92 million, or 6.4% of net sales, compared with $77 million, or 5.8% of net sales, for the same period one-year ago. The increase in operating income was attributable to: (i) the 10% increase in net sales; (ii) a 0.3 ppt. improvement in our gross profit rate; and (iii) the operating expense leverage resulting from a 10% increase in net sales, partially offset by transition costs associated with the launch of our Sleep Number 360 smart beds and evolution of our supply chain.
- Net income in 2017 increased 27% to $65 million, or $1.55 per diluted share, compared with net income of $51 million, or $1.10 per diluted share in 2016.

- We achieved a return on invested capital (ROIC) of 14.3% in 2017, well above our weighted average cost of capital.
- Cash provided by operating activities increased by 14% in 2017 to $173 million, compared with $152 million for the prior year. Purchases of property and equipment for 2017 increased to $60 million, compared with $58 million in 2016.
- At December 30, 2017, cash and cash equivalents totaled $4 million compared with $12 million at December 31, 2016. We ended 2017 with $25 million of borrowings under our $153 million revolving credit facility, as planned. We utilize our credit facility for general corporate purposes and to meet our seasonal working capital requirements. In February 2018, we amended our revolving credit facility to increase our net aggregate availability to $300 million.
- Effective as of October 1, 2017, our Board approved an increase in our total remaining share repurchase authorization to $500 million. In 2017, we repurchased 5.4 million shares of our common stock at a cost of $150 million ($28.00 per share). As of December 30, 2017, the remaining authorization under our Board-approved share repurchase program was $465 million.

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.

	2017		2016		2015	
	$	% of Net Sales	$	% of Net Sales	$	% of Net Sales
Net sales	$ 1,444.5	100.0%	$ 1,311.3	100.0%	$ 1,213.7	100.0%
Cost of sales	547.2	37.9	501.1	38.2	472.9	39.0
Gross profit	897.3	62.1	810.2	61.8	740.8	61.0
Operating expenses:						
Sales and marketing	650.4	45.0	595.8	45.4	550.5	45.4
General and administrative	127.3	8.8	109.7	8.4	99.2	8.2
Research and development	27.8	1.9	28.0	2.1	16.0	1.3
Total operating expenses	805.4	55.8	733.5	55.9	665.7	54.8
Operating income	91.9	6.4	76.7	5.8	75.1	6.2
Other (expense) income, net	(0.9)	(0.1)	(0.7)	(0.1)	0.3	0.0
Income before income taxes	91.0	6.3	75.9	5.8	75.4	6.2
Income tax expense	26.0	1.8	24.5	1.9	24.9	2.1
Net income	$ 65.1	4.5%	$ 51.4	3.9%	$ 50.5	4.2%
Net income per share:						
Basic	$ 1.58		$ 1.11		$ 0.99	
Diluted	$ 1.55		$ 1.10		$ 0.97	
Weighted-average number of common shares:						
Basic	41.2		46.2		51.3	
Diluted	42.1		46.9		52.1	

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

	2017	2016	2015
Company-Controlled channel	98.7%	97.7%	97.6%
Wholesale/Other channel	1.3%	2.3%	2.4%
Total	100.0%	100.0%	100.0%

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

	Net Sales Increase/(Decrease)		
	2017	2016	2015
Retail comparable-store sales[(1)]	3%	0%	3%
Online and phone[(1)]	16%	25%	(4%)
Company-Controlled comparable sales change[(1)]	4%	1%	3%
Net opened/closed stores	7%	7%	2%
Total Company-Controlled channel	11%	8%	5%
Wholesale/Other channel	(38%)	5%	(9%)
Total net sales change	10%	8%	5%

(1) Stores are included in the comparable-store calculation 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:

	2017	2016	2015
Average sales per store[(1)] ($ in thousands)	$ 2,420	$ 2,364	$ 2,377
Average sales per square foot[(1)]	$ 920	$ 937	$ 980
Stores > $1 million in net sales[(1)]	98%	98%	99%
Stores > $2 million in net sales[(1)]	61%	61%	62%
Average revenue per mattress unit – Company-Controlled channel[(2)]	$ 4,283	$ 4,046	$ 4,028

(1) Trailing twelve months for stores included in our comparable-store sales calculation.
(2) Represents Company-Controlled channel total net sales divided by Company-Controlled channel mattress units.

The number of retail stores operating during the last three years was as follows:

	2017	2016	2015
Beginning of period	540	488	463
Opened	36	72	38
Closed	(20)	(20)	(13)
End of period	556	540	488

Comparison of 2017 and 2016

Net sales

Net sales in 2017 increased 10% to $1.44 billion, compared with $1.31 billion for the same period one year ago. The sales increase was driven by a 4% comparable sales increase in our Company-Controlled channel and 7 percentage points (ppt.) of growth from sales generated by 16 net new retail stores opened in the past 12 months, partially offset by a decrease in Wholesale/Other channel sales.

The $133 million net sales increase compared with the same period one year ago was primarily comprised of: (i) a $91 million increase resulting from net store openings; and (ii) a $54 million sales increase from Company-Controlled comparable sales; partially offset by (iii) a $12 million decrease in Wholesale/Other channel sales. Company-Controlled mattress units increased 5% compared to the prior-year period. Average revenue per mattress unit in our Company-Controlled channel increased by 6%.

Gross profit

Gross profit of $897 million increased by $87 million, or 11%, compared with $810 million for the same period one year ago. The gross profit rate increased to 62.1% of net sales for 2017, compared with 61.8% for the prior-year period. The prior-year gross profit rate was negatively impacted by actions taken to manage operating issues associated with our ERP implementation during the first six months of 2016. The current-year gross profit rate improvement of 0.3 ppt. benefited from manufacturing and supply chain efficiencies, including lean initiatives, and lower sales return and exchange costs compared with the same period one year ago. In addition, our gross profit rate can fluctuate from year to year due to a variety of other factors, including warranty expenses, product mix changes and performance-based incentive compensation.

Sales and marketing expenses

Sales and marketing expenses in 2017 increased 9% to $650 million, compared with $596 million last year. The sales and marketing expense rate decreased to 45.0% of net sales compared with 45.4% for the same period one year ago due to: (i) leveraging our media spending, which increased by 2% compared with the prior year, while net sales increased by 10%; partially offset by (ii) an increase in customer financing expenses, as a larger percentage of our customers took advantage of promotional financing offers; and (iii) an increase in selling compensation expense, including higher performance-based incentive compensation resulting from the strong 2017 net sales growth and financial performance.

General and administrative expenses

General and administrative (G&A) expenses increased $18 million to $127 million in 2017, compared with $110 million in the prior year and increased to 8.8% of net sales, compared with 8.4% of net sales one year ago. The $18 million increase in G&A expenses consisted of the following major components: (i) a $12.2 million increase in employee compensation, including a year-over-year increase in company-wide performance-based incentive compensation, enhanced digital marketing capabilities, and salary and wage rate increases that were in line with inflation; (ii) $2.6 million of additional depreciation and amortization expense, including incremental depreciation expense from capital expenditures that support the growth of our business; and (iii) a $2.8 million increase in miscellaneous other expenses. The G&A expense rate increased by 0.4 ppt. in 2017 compared with the same period one year ago due to the increase in expenses discussed above, partially offset by the leveraging impact of the 10% net sales increase.

Research and development expenses

Research and development expenses for the year ended December 30, 2017 were $28 million, consistent with the same period one year ago. The expense rate for the year ended December 30, 2017 decreased to 1.9% of net sales compared to 2.1% of net sales for the prior year. The spending level is consistent with our long-term consumer innovation strategy.

Income tax expense

Income tax expense was $26 million for the year ended December 30, 2017, compared with $25 million for the same period one year ago. The effective tax rate for the year ended December 30, 2017 was 28.5% compared with 32.3% for the prior-year period. The effective tax rates for 2016 reflects tax benefits associated with our acquisition of BAM Labs, Inc. including higher research and development tax credits. The effective tax rate for 2017 benefited from: (i) a provisional tax benefit resulting from revaluing deferred taxes in accordance with the "Tax Cuts and Jobs Act"; (ii) stock-based compensation excess tax benefits in accordance with new Financial Accounting Standards Board (FASB) guidance effective for us beginning in 2017; and (iii) the recognition of additional tax credits. Under previous FASB guidance, stock-based compensation excess tax benefits or deficiencies were recognized in additional paid-in capital in our consolidated balance sheet. See Note 1, *New Accounting Pronouncements*, in the Notes to the Condensed Consolidated Financial Statements for additional details.

Comparison of 2016 and 2015

Enterprise Resource Planning (ERP) system implementation

In the fourth quarter of 2015, we replaced our nearly 20-year-old legacy computer systems with a new vertically integrated Enterprise Resource Planning (ERP) system. We completed our ERP implementation by the end of the first quarter of 2016. Implementation issues negatively affected fourth-quarter 2015 net sales and profits, and to a lesser degree, first-quarter and second-quarter 2016 net sales and profits. The new operating platform enables operational efficiencies, improved customer convenience and supports the growth of our business.

Net sales

Net sales in 2016 increased 8% to $1.31 billion, compared with $1.21 billion for the same period one year ago. The sales increase was driven by a 1% comparable sales increase in our Company-Controlled channel, 7 percentage points (ppt.) of growth from sales generated by 52 net new retail stores opened in the past 12 months and an increase in Wholesale/Other channel sales.

The $98 million net sales increase compared with the same period one year ago was primarily comprised of an $83 million increase resulting from net store openings and a $14 million sales increase from Company-Controlled comparable sales. Company-Controlled mattress units increased 8% compared to the prior-year period. Average revenue per mattress unit in our Company-Controlled channel was consistent with the prior year.

Gross profit

Gross profit of $810 million increased by $69 million, or 9%, compared with the same period one year ago. The gross profit rate increased to 61.8% of net sales for 2016, compared with 61.0% for the prior-year period. The 0.8 ppt. increase in the gross profit rate was primarily due to material cost reductions, operating efficiencies, and lower sales return and exchange costs. In addition, our gross profit rate can fluctuate from year-to-year due to a variety of other factors, including warranty expenses, product mix changes and performance-based incentive compensation.

Sales and marketing expenses

Sales and marketing expenses in 2016 increased 8% to $596 million, compared with $550 million last year. The marketing expense rate of 45.4% of net sales was consistent with the same period one year ago due to: (i) leveraging our media spending, which increased by 5% compared with the prior year, while net sales increased by 8%; partially offset by (ii) higher customer service costs; and (iii) an increase in customer financing expenses, as a larger percentage of our customers took advantage of promotional financing offers.

General and administrative expenses

General and administrative (G&A) expenses increased $10.5 million to $110 million in 2016, compared with $99 million in the prior year and increased to 8.4% of net sales, compared with 8.2% of net sales one year ago. The $10.5 million increase in G&A expenses consisted of the following major components: (i) a $10.4 million increase in employee compensation, including headcount increases to support business growth initiatives, and salary and wage rate increases that were in line with inflation; (ii) $6.5 million of additional depreciation expense resulting from the increase in capital expenditures to support the growth of the business, including our new ERP system that was launched in the fourth quarter of 2015; (iii) a $3.5 million gain (net of acquisition-related expenses) in 2015 related to our previously held minority equity investment in BAM Labs, Inc.; and (iv) a $1.5 million increase in miscellaneous other expenses. These increases were partially offset by $11.6 million of data conversion and training expenses incurred in 2015 to support the launch of our ERP system. The G&A expense rate increased by 0.2 ppt. in 2016 compared with the same period one year ago due to the increase in expenses discussed above, partially offset by the leveraging impact of the 8% net sales increase.

Research and development expenses

Research and development expenses for the year ended December 31, 2016 were $28 million, or 2.1% of net sales, compared with $16 million, or 1.3% of net sales, for the same period one year ago. The $12 million increase in R&D expenses was due to increased investments to support product innovations, including a $9.7 million increase in expenses related to SleepIQ LABS' operations (post acquisition; acquired on September 15, 2015). The $12 million increase is consistent with our long-term consumer innovation strategy.

Income tax expense

Income tax expense was $25 million for the year ended December 31, 2016, compared with $25 million for the same period one year ago. The effective tax rate for the year ended December 31, 2016 was 32.3% compared with 33.0% for the prior-year period. The effective tax rates for 2016 and 2015 include tax benefits associated with our acquisition of BAM Labs, including higher research and development tax credits.

Liquidity and Capital Resources

Managing our liquidity and capital resources is an important part of our commitment to deliver superior shareholder value. Our business model, which can operate with minimal working capital, does not require additional capital from external sources to fund operations or organic growth. Our primary sources of liquidity are cash flows provided by operating activities and cash available under our $300 million revolving credit facility (increased in February 2018 from $153 million). 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.

As of December 30, 2017, cash and cash equivalents totaled $4 million compared with $12 million as of December 31, 2016. The $8 million decrease was primarily due to $173 million of cash provided by operating activities and $25 million of borrowings under our line of credit, which was more than offset by $60 million of cash used to purchase property and equipment and $155 million of cash used to repurchase our common stock ($150 million under our Board-approved share repurchase program and $5 million in connection with the vesting of employee restricted stock grants).

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

	2017	2016
Total cash provided by (used in):		
Operating activities	$ 172.6	$ 151.6
Investing activities	(56.6)	(42.7)
Financing activities	(123.9)	(118.4)
Net decrease in cash and cash equivalents	$ (8.0)	$ (9.4)

Cash provided by operating activities for the fiscal year ended December 30, 2017 was $173 million compared with $152 million for the fiscal year ended December 31, 2016. Significant components of the $21 million year-over-year change in cash from operating activities included: (i) a $14 million increase in net income in 2017 compared with 2016; (ii) a $23 million fluctuation in income taxes based on a $15 million income taxes receivable at the end of 2015 compared with income tax liabilities at the end of 2016 and 2017; (iii) a $13 million fluctuation in accrued compensation and benefits due to the year-over-year changes in company-wide performance-based incentive compensation resulting from the strong 2017 financial performance; and (iv) the ERP implementation issues we experienced in our plants and supply chain during the fourth quarter of 2015 that resulted in higher inventory levels, increased accounts receivables, increased accounts payables and higher customer prepayments at the end of 2015.

Net cash used in investing activities was $57 million for the fiscal year ended December 30, 2017, compared with $43 million for the same period one year ago. Investing activities for the current-year period included $60 million of property and equipment purchases, compared with $58 million for the same period last year. We decreased our net investments in marketable debt securities by $15 million during the fiscal year ended December 31, 2016 and held no marketable debt securities at December 30, 2017 or December 31, 2016.

Net cash used in financing activities was $124 million for the fiscal year ended December 30, 2017, compared with net cash used in financing activities of $118 million for the same period one year ago. During the fiscal year ended December 30, 2017, we repurchased $155 million of our common stock ($150 million under our Board-approved share repurchase program and $5 million in connection with the vesting of employee restricted stock grants) compared with $127 million during the same period one year ago.

Short-term borrowings increased by $22 million during the current-year period, reflecting $25 million of borrowings under our revolving credit facility as of December 30, 2017, compared with no borrowing as of December 31, 2016. Changes in book overdrafts are included in the net change in short-term borrowings. Financing activities for both periods reflect the cash proceeds from the exercise of employee stock options.

Under our Board-approved share repurchase program, we repurchased 5.4 million shares at a cost of $150 million ($28.00 per share) during the fiscal year ended December 30, 2017. During 2016, we repurchased 5.9 million shares at a cost of $125 million ($21.02 per share). Effective as of October 1, 2017, our Board approved an increase in our total remaining share repurchase authorization to $500 million. As of December 30, 2017, the remaining authorization under our Board-approved share repurchase program was $465 million. There is no expiration date governing the period over which we can repurchase shares.

In February 2018, we amended our revolving credit facility (Credit Agreement) with a syndicate of banks (Lenders). The Credit Agreement provides a revolving credit facility for general corporate purposes with net aggregate availability of $300 million. The Credit Agreement contains an accordion feature that allows us to increase the amount of the credit facility from $300 million up to $450 million in total availability, subject to Lenders' approval. The Credit Agreement matures in February 2023.

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 and a minimum interest coverage ratio. Under the terms of the credit agreement we pay a variable rate of interest and a commitment fee based on our leverage ratio. As of December 30, 2017, we had $25 million in outstanding borrowings and $3 million in outstanding letters of credit. As of December 30, 2017, the weighted-average interest rate on borrowings outstanding under the credit facility was 3.1%. 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 certain financial covenants, including a maximum leverage ratio and a minimum interest coverage ratio. As of December 30, 2017, 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.

Off-Balance-Sheet Arrangements and Contractual Obligations

As of December 30, 2017, we were not involved in any unconsolidated special purpose entity transactions. Other than our operating leases and a $3 million outstanding letter of credit, we do not have any off-balance-sheet financing. A summary of our operating lease obligations is included in the "Contractual Obligations" section (as follows). Additional information regarding our operating leases is available in Item 2, *Properties*, and Note 7, *Leases*, of the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K.

Contractual Obligations

The following table presents information regarding our contractual obligations as of December 30, 2017 (in thousands):

	Payments Due by Period[1]				
	Total	< 1 Year	1 - 3 Years	3 - 5 Years	> 5 Years
Operating leases[2]	$ 436,767	$ 70,604	$ 123,183	$ 97,941	$ 145,039
Purchase commitments	8,600	8,600	—	—	—
Total	$ 445,367	$ 79,204	$ 123,183	$ 97,941	$ 145,039

(1) Our unrecognized tax benefits, including interest and penalties, of $3 million have not been included in the Contractual Obligations table as we are not able to determine a reasonable estimate of timing of the cash settlement with the respective taxing authorities.

(2) These amounts include the payments related to 38 lease commitments for future retail store locations. These lease commitments provide for minimum rentals over the next five to ten years, which if consummated based on current cost estimates, would approximate $54 million over the initial lease term.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP). In connection with the preparation of our financial statements, we are required to make estimates and assumptions about future events, and apply judgments that affect the reported amounts of assets, liabilities, sales, expenses and the related disclosure. Predicting future events is inherently an imprecise activity and as such requires the use of judgment. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time our consolidated financial statements are prepared. On a regular basis, management reviews the accounting policies, assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

Our significant accounting policies are discussed in Note 1, *Business and Summary of Significant Accounting Policies*, of the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K. Management believes the accounting policies discussed below are the most critical because they require management's most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain. Management has reviewed these critical accounting policies and estimates, and related disclosures with the Audit Committee of our Board.

Our critical accounting policies and estimates relate to stock-based compensation, goodwill and indefinite-lived intangible assets, warranty liabilities and revenue recognition.

Description	Judgments and Uncertainties	Effect if Actual Results Differ From Assumptions
Stock-Based Compensation		
We have stock-based compensation plans, which include non-qualified stock options and stock awards. See Note 1, *Business and Summary of Significant Accounting Policies*, and Note 10, *Shareholders' Equity*, to the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K, for a complete discussion of our stock-based compensation programs.	Option-pricing models and generally accepted valuation techniques require management to make assumptions and to apply judgment to determine the fair value of our awards. These assumptions and judgments include estimating the volatility of our stock price, future employee forfeiture rates and future employee stock option exercise behaviors. Changes in these assumptions can materially affect the fair value estimates or future earnings adjustments. Performance-based stock awards require management to make assumptions regarding the likelihood of achieving performance targets.	We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine stock-based compensation expense. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to changes in stock-based compensation expense that could be material. In addition, if actual results are not consistent with the assumptions used, the stock-based compensation expense reported in our financial statements may not be representative of the actual economic cost of the stock-based compensation. Finally, if the actual forfeiture rates, or the actual achievement of performance targets, are not consistent with the assumptions used, we could experience future earnings adjustments. A 10% change in our stock-based compensation expense for the year ended December 30, 2017, would have affected net income by approximately $1.1 million in 2017.
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. See Note 1, *Business and Summary of Significant Accounting Policies* and Note 7, *Goodwill and Intangible Assets, Net*, to the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K, for a complete discussion of our goodwill and indefinite-lived intangible assets.	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 2017, 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.

Description	Judgments and Uncertainties	Effect if Actual Results Differ From Assumptions
Warranty Liabilities		
We provide a limited warranty on most of the products we sell. See Note 1, *Business and Summary of Significant Accounting Policies*, to the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K, for a complete discussion of our warranty program and liabilities.	The majority of our warranty claims are incurred within the first year. However, our warranty liability contains uncertainties because our warranty obligations cover an extended period of time. A revision of estimated claim rates or the projected cost of materials and freight associated with sending replacement parts to customers could have a material adverse effect on future results of operations.	We have not made any material changes in our warranty liability assessment methodology during the past three fiscal years. We do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions we use to calculate our warranty liability. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to losses or gains that could be material. A 10% change in our warranty liability at December 30, 2017, would have affected net income by approximately $0.6 million in 2017.
Revenue Recognition		
Certain accounting estimates relating to revenue recognition contain uncertainty because they require management to make assumptions and to apply judgment regarding the effects of future events. See Note 1, *Business and Summary of Significant Accounting Policies*, to the Notes to Consolidated Financial Statements, included in Item 8, *Financial Statements and Supplementary Data*, of this Annual Report on Form 10-K, for a complete discussion of our revenue recognition policies.	Our estimates of sales returns contain uncertainties as actual sales return rates may vary from expected rates, resulting in adjustments to net sales in future periods. These adjustments could have an adverse effect on future results of operations.	We have not made any material changes in the accounting methodology used to establish our sales returns allowance during the past three fiscal years. We do not believe there is a reasonable likelihood that there will be a material change in the estimates or assumptions we use to calculate our sales returns allowance. However, if actual results are not consistent with our estimates or assumptions, we may be exposed to additional losses or gains in future periods. A 10% change in our sales returns allowance at December 30, 2017 would have affected net income by approximately $1.3 million in 2017.

Recent Accounting Pronouncements

See “Part II, Item 8. Financial Statements and Supplementary Data – Notes to Consolidated Financial Statements – Note 1 – Business and Summary of Significant Accounting Policies - New Accounting Pronouncements” for recent accounting pronouncements that may affect our financial reporting.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to changes in short-term market interest rates that will impact our net interest expense. If overall interest rates were one percentage point higher than current rates, our net interest expense would not change by a significant amount based on the $25 million of borrowings under our revolving credit facility at December 30, 2017. We do not manage our interest-rate volatility risk through the use of derivative instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Sleep Number Corporation
Minneapolis, Minnesota

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Sleep Number Corporation and subsidiaries (the "Company," formerly Select Comfort Corporation) as of December 30, 2017 and December 31, 2016, the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 30, 2017, and the related notes and the schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 30, 2017 and December 31, 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 30, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 30, 2017, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 27, 2018

We have served as the Company's auditor since 2010.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Sleep Number Corporation
Minneapolis, Minnesota

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Sleep Number Corporation and subsidiaries (the "Company," formerly Select Comfort Corporation) as of December 30, 2017, based on the criteria established in *Internal Control-Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 30, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements and financial statement schedule as of and for the year ended December 30, 2017, of the Company and our report dated February 27, 2018 expressed an unqualified opinion on those financial statements and financial statement schedule.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control over Financial Reporting

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

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

/s/ DELOITTE & TOUCHE LLP

Minneapolis, Minnesota
February 27, 2018

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Balance Sheets
December 30, 2017 and December 31, 2016
(in thousands, except per share amounts)

	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	$ 3,651	$ 11,609
Accounts receivable, net of allowance for doubtful accounts of $714 and $884, respectively	19,312	19,705
Inventories	84,298	75,026
Prepaid expenses	17,565	8,705
Other current assets	27,665	23,282
Total current assets	152,491	138,327
Non-current assets:		
Property and equipment, net	208,646	208,367
Goodwill and intangible assets, net	77,588	80,817
Deferred income taxes	2,625	4,667
Other non-current assets	30,484	24,988
Total assets	$ 471,834	$ 457,166
Liabilities and Shareholders' Equity		
Current liabilities:		
Borrowings under revolving credit facility	$ 24,500	$ —
Accounts payable	129,194	105,375
Customer prepayments	27,767	26,207
Accrued sales returns	19,270	15,222
Compensation and benefits	34,602	19,455
Taxes and withholding	24,234	23,430
Other current liabilities	46,822	35,628
Total current liabilities	306,389	225,317
Non-current liabilities:		
Other non-current liabilities	76,289	71,529
Total liabilities	382,678	296,846
Shareholders' equity:		
Undesignated preferred stock; 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, $0.01 par value; 142,500 shares authorized, 38,813 and 43,569 shares issued and outstanding, respectively	388	436
Additional paid-in capital	—	—
Retained earnings	88,768	159,884
Total shareholders' equity	89,156	160,320
Total liabilities and shareholders' equity	$ 471,834	$ 457,166

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Operations
Years ended December 30, 2017, December 31, 2016 and January 2, 2016
(in thousands, except per share amounts)

	2017	2016	2015
Net sales	$ 1,444,497	$ 1,311,291	$ 1,213,699
Cost of sales	547,150	501,131	472,948
Gross profit	897,347	810,160	740,751
Operating expenses:			
Sales and marketing	650,357	595,845	550,475
General and administrative	127,269	109,674	99,209
Research and development	27,806	27,991	15,971
Total operating expenses	805,432	733,510	665,655
Operating income	91,915	76,650	75,096
Other (expense) income, net	(877)	(717)	334
Income before income taxes	91,038	75,933	75,430
Income tax expense	25,961	24,516	24,911
Net income	$ 65,077	$ 51,417	$ 50,519
Basic net income per share:			
Net income per share – basic	$ 1.58	$ 1.11	$ 0.99
Weighted-average shares – basic	41,212	46,154	51,252
Diluted net income per share:			
Net income per share – diluted	$ 1.55	$ 1.10	$ 0.97
Weighted-average shares – diluted	42,085	46,902	52,101

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income
Years ended December 30, 2017, December 31, 2016 and January 2, 2016
(in thousands)

	2017	2016	2015
Net income	$ 65,077	$ 51,417	$ 50,519
Other comprehensive income – unrealized gain on available-for-sale marketable debt securities, net of income tax	—	14	20
Comprehensive income	$ 65,077	$ 51,431	$ 50,539

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity
Years ended December 30, 2017, December 31, 2016 and January 2, 2016
(in thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total
	Shares	Amount				
Balance at January 3, 2015	52,798	$ 528	$ —	$ 256,413	$ (34)	$ 256,907
Net income	—	—	—	50,519	—	50,519
Other comprehensive income:						
Unrealized gain on available-for-sale marketable debt securities, net of tax	—	—	—	—	20	20
Exercise of common stock options	253	3	2,973	—	—	2,976
Tax effect from stock-based compensation	—	—	1,828	—	—	1,828
Stock-based compensation	(7)	—	10,290	—	—	10,290
Repurchases of common stock	(3,642)	(37)	(15,091)	(85,073)	—	(100,201)
Balance at January 2, 2016	49,402	$ 494	$ —	$ 221,859	$ (14)	$ 222,339
Net income	—	—	—	51,417	—	51,417
Other comprehensive income:						
Unrealized gain on available-for-sale marketable debt securities, net of tax	—	—	—	—	14	14
Exercise of common stock options	188	2	2,296	—	—	2,298
Tax effect from stock-based compensation	—	—	(1,016)	—	—	(1,016)
Stock-based compensation	11	—	11,961	—	—	11,961
Repurchases of common stock	(6,032)	(60)	(13,241)	(113,392)	—	(126,693)
Balance at December 31, 2016	43,569	$ 436	$ —	$ 159,884	$ —	$ 160,320
Net income	—	—	—	65,077	—	65,077
Exercise of common stock options	222	2	3,239	—	—	3,241
Stock-based compensation	594	6	15,757	—	—	15,763
Repurchases of common stock	(5,572)	(56)	(18,996)	(136,193)	—	(155,245)
Balance at December 30, 2017	38,813	$ 388	$ —	$ 88,768	$ —	$ 89,156

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Cash Flows
Years Ended December 30, 2017, December 31, 2016 and January 2, 2016
(in thousands)

	2017	2016	2015
Cash flows from operating activities:			
Net income	$ 65,077	$ 51,417	$ 50,519
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	61,291	57,172	47,630
Stock-based compensation	15,763	11,961	10,290
Net loss on disposals and impairments of assets	249	27	190
Excess tax benefits from stock-based compensation	—	(517)	(2,182)
Deferred income taxes	2,042	(1,640)	11,924
Gain on sale of non-marketable equity securities	—	—	(6,891)
Changes in operating assets and liabilities, net of effect of acquisition:			
Accounts receivable	393	9,297	(9,259)
Inventories	(9,272)	11,574	(33,065)
Income taxes	1,697	25,119	(13,943)
Prepaid expenses and other assets	(12,405)	(2,195)	8,680
Accounts payable	21,779	(4,965)	19,130
Customer prepayments	1,560	(25,266)	22,735
Accrued compensation and benefits	15,398	2,808	(17,493)
Other taxes and withholding	(893)	2,723	135
Other accruals and liabilities	9,928	14,130	19,542
Net cash provided by operating activities	172,607	151,645	107,942
Cash flows from investing activities:			
Purchases of property and equipment	(59,829)	(57,852)	(85,586)
Decrease in restricted cash	3,150	—	—
Proceeds from sales of property and equipment	36	92	72
Proceeds from marketable debt securities	—	21,053	127,664
Investments in marketable debt securities	—	(5,968)	(29,299)
Acquisition of business	—	—	(70,018)
Proceeds from non-marketable equity securities	—	—	12,891
Net cash used in investing activities	(56,643)	(42,675)	(44,276)
Cash flows from financing activities:			
Repurchases of common stock	(155,245)	(126,693)	(100,201)
Net increase in short-term borrowings	28,094	5,932	1,097
Proceeds from issuance of common stock	3,241	2,298	2,976
Debt issuance costs	(12)	(409)	(721)
Excess tax benefits from stock-based compensation	—	517	2,182
Net cash used in financing activities	(123,922)	(118,355)	(94,667)
Net decrease in cash and cash equivalents	(7,958)	(9,385)	(31,001)
Cash and cash equivalents, at beginning of period	11,609	20,994	51,995
Cash and cash equivalents, at end of period	$ 3,651	$ 11,609	$ 20,994
Supplemental Disclosure of Cash Flow Information			
Income taxes paid (received)	$ 22,807	$ (653)	$ 26,681
Interest paid	$ 753	$ 608	$ 96
Purchases of property and equipment included in accounts payable	$ 3,964	$ 5,517	$ 5,051

See accompanying notes to consolidated financial statements.

**SLEEP NUMBER CORPORATION
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(1) Business and Summary of Significant Accounting Policies

Business & Basis of Presentation

Sleep Number Corporation (previously Select Comfort Corporation) and our 100%-owned subsidiaries (Sleep Number or the Company) have a vertically integrated business model and are the exclusive designer, manufacturer, marketer, retailer and servicer of Sleep Number® beds. We are the pioneer in biometric sleep tracking and adjustability. Only the Sleep Number bed offers SleepIQ technology - a proprietary sensor technology that tracks each individual's sleep and works directly with the bed's DualAir system to automatically adjust the comfort level of each sleeper. SleepIQ technology communicates how you slept and provides insights on what adjustments you can make to optimize your sleep and improve your daily life. Sleep Number also offers FlextFit adjustable bases, and Sleep Number pillows, sheets and other bedding products.

We generate revenue by marketing our innovations to new and existing customers, and selling products through two distribution channels. Our Company-Controlled channel, which includes retail, online and phone, sells directly to consumers. Our Wholesale/ Other channel sells to and through selected retail and wholesale customers in the United States.

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

Fiscal Year

Our fiscal year ends on the Saturday closest to December 31. Fiscal years and their respective fiscal year ends were as follows: fiscal 2017 ended December 30, 2017; fiscal 2016 ended December 31, 2016; and fiscal 2015 ended January 2, 2016. Fiscal years 2017, 2016 and 2015 each had 52 weeks.

Use of Estimates in the Preparation of Financial Statements

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (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 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. Changes in these estimates will be reflected in the financial statements in future periods. Our critical accounting policies consist of stock-based compensation, goodwill and indefinite-lived intangible assets, warranty liabilities and revenue recognition.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less. The carrying value of these investments approximates fair value due to their short-term maturity. Our banking arrangements allow us to fund outstanding checks when presented to the financial institution for payment, resulting in book overdrafts. Book overdrafts are included in accounts payable in our consolidated balance sheets and in net increase in short-term borrowings in the financing activities section of our consolidated statements of cash flows. Book overdrafts totaled $30 million and $27 million at December 30, 2017, and December 31, 2016, respectively.

Concentration of Credit Risk

Our investment policy's primary focus is to preserve principal and maintain adequate liquidity. Our investment policy addresses the concentration of credit risk by limiting the concentration in certain investment types. Our exposure to a concentration of credit risk consists primarily of cash and cash equivalents. We place our cash with high-credit quality issuers and financial institutions. Prior to 2017 we held investments in U.S. agency securities, corporate debt securities and municipal bonds. We believe no significant concentration of credit risk exists with respect to our cash and cash equivalents.

Accounts Receivable

Accounts receivable are recorded net of an allowance for expected losses and consist primarily of receivables from wholesale customers and receivables from third-party financiers for customer credit card purchases. The allowance is recognized in an amount equal to anticipated future write-offs. We estimate future write-offs based on delinquencies, aging trends, industry risk trends, our historical experience and current trends. Account balances are charged off against the allowance when we believe it is probable the receivable will not be recovered.

Inventories

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

Property and Equipment

Property and equipment, carried at cost, is depreciated using the straight-line method over the estimated useful lives of the assets. The cost and related accumulated depreciation of assets sold or retired is removed from the accounts with any resulting gain or loss included in net income in our consolidated statements of operations. Maintenance and repairs are charged to expense as incurred. Major renewals and betterments that extend useful life are capitalized.

Leasehold improvements are depreciated over the shorter of the estimated useful lives of the assets or the contractual term of the lease, with consideration of lease renewal options if renewal appears probable.

Estimated useful lives of our property and equipment by major asset category are as follows:

Leasehold improvements	5 to 15 years
Furniture and equipment	5 to 15 years
Production machinery	3 to 7 years
Computer equipment and software	3 to 12 years

Goodwill and Intangible Assets, Net

Goodwill is the difference between the purchase price of a company and the fair market value of the acquired company's net identifiable assets. Our intangible assets include developed technologies, trade names/trademarks and customer relationships. Definite-lived intangible assets are being amortized using the straight-line method over their estimated lives, ranging from 8-10 years.

Asset Impairment Charges

<u>Long-lived Assets and Definite-lived Intangible Assets</u> - we review our long-lived assets and definite-lived intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. When evaluating long-lived assets for potential impairment, we first compare the carrying value of the asset to the estimated future cash flows (undiscounted and without interest charges - plus proceeds expected from disposition, if any). If the estimated undiscounted cash flows are less than the carrying value of the asset, we calculate an impairment loss. The impairment loss calculation compares the carrying value of the asset to the asset's estimated fair value. When we recognize an impairment loss, the carrying amount of the asset is reduced to estimated fair value based on discounted cash flows, quoted market prices or other valuation techniques. Assets to be disposed of are reported at the lower of the carrying amount of the asset or fair value less costs to sell. We review retail store assets for potential impairment based on historical cash flows, lease termination provisions and expected future retail store operating results. If we recognize an impairment loss for a depreciable long-lived asset, the adjusted carrying amount of the asset becomes its new cost basis and will be depreciated (amortized) over the remaining useful life of that asset.

<u>Goodwill and Indefinite-lived Intangible Assets</u> - goodwill and indefinite-lived intangible assets are not amortized, but are tested for impairment annually or when there are indicators of impairment using a fair value approach. The Financial Accounting Standards Board's (FASB) guidance allows us to perform either a quantitative assessment or a qualitative assessment before calculating the fair

value of a reporting unit. We have elected to perform the quantitative assessment. The quantitative goodwill impairment test is a two-step process. The first step is a comparison of the fair value of the reporting unit with its carrying amount, including goodwill. If this step reflects impairment, then the loss would be measured as the excess of recorded goodwill over its implied fair value. Implied fair value is the excess of fair value of the reporting unit over the fair value of all identified assets and liabilities. Fair value is determined using a market-based approach utilizing widely accepted valuation techniques, including quoted market prices and our market capitalization. Indefinite-lived intangible assets are assessed for impairment by comparing the carrying value of an asset with its fair value. If the carrying value exceeds fair value, an impairment loss is recognized in an amount equal to the excess. Based on our 2017 assessments, we determined there was no impairment.

Warranty Liabilities

We provide a limited warranty on most of the products we sell. The estimated warranty costs, which are expensed at the time of sale and included in cost of sales, are based on historical trends and warranty claim rates incurred by us and are adjusted for any current trends as appropriate. Actual warranty claim costs could differ from these estimates. We regularly assess and adjust the estimate of accrued warranty claims by updating claims rates for actual trends and projected claim costs.

We classify as non-current those estimated warranty costs expected to be paid out in greater than one year. The activity in the accrued warranty liabilities account was as follows (in thousands):

	2017	2016	2015
Balance at beginning of period	$ 8,633	$ 10,028	$ 5,824
Additions charged to costs and expenses for current-year sales	12,214	9,034	9,368
Deductions from reserves	(10,752)	(10,016)	(6,486)
Changes in liability for pre-existing warranties during the current year, including expirations	(775)	(413)	1,322
Balance at end of period	$ 9,320	$ 8,633	$ 10,028

Fair Value Measurements

Fair value measurements are reported in one of three levels based on the lowest level of significant input used:

- Level 1 – observable inputs such as quoted prices in active markets;
- Level 2 – inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3 – unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

We generally estimate fair value of long-lived assets, including our retail stores, using the income approach, which we base on estimated future cash flows (discounted and with interest charges). The inputs used to determine fair value relate primarily to future assumptions regarding sales volumes, gross profit rates, retail store operating expenses and applicable probability weightings regarding future alternative uses. These inputs are categorized as Level 3 inputs under the fair value measurements guidance. The inputs used represent management's assumptions about what information market participants would use in pricing the assets and are based upon the best information available at the balance sheet date.

Dividends

We are not restricted from paying cash dividends under our credit agreement so long as we are not in default under the credit agreement and so long as the payment of such dividends would not create an event of default. However, we have not historically paid, and have no current plans to pay, cash dividends on our common stock.

Revenue Recognition

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

We accept sales returns during a 100-night trial period. The accrued sales returns estimate is based on historical return rates and is adjusted for any current trends as appropriate. If actual returns vary from expected rates, sales in future periods are adjusted.

Our SleepIQ system is a multiple-element arrangement with deliverables that include a bed, hardware and software. We analyze our multiple-element arrangement(s) to determine whether the deliverables can be separated or whether they must be accounted for as a single unit of accounting. We determined that the SleepIQ system has two units of accounting consisting of: (i) the bed; and (ii) the hardware/software. The hardware and software are not separable as the hardware and related software are not sold separately and the software is integral to the hardware's functionality. We valued the two units of accounting based on their relative selling prices.

At December 30, 2017 and December 31, 2016, we had deferred revenue totaling $73 million and $61 million, of which $30 million and $21 million are included in other current liabilities, respectively, and $43 million and $40 million are included in other non-current liabilities, respectively, in our consolidated balance sheets. We also have related deferred costs totaling $43 million and $33 million, of which $17 million and $12 million are included in other current assets, respectively, and $26 million and $22 million are included in other non-current assets, respectively, in our consolidated balance sheets. The deferred revenue and costs are recognized over the product's estimated life of four years.

Cost of Sales, Sales and Marketing, General and Administrative (G&A) and Research & Development (R&D) Expenses

The following tables summarize the primary costs classified in each major expense category (the classification of which may vary within our industry):

Cost of Sales

- Costs associated with purchasing, manufacturing, shipping, handling and delivering our products to our retail stores and customers;
- Physical inventory losses, scrap and obsolescence;
- Related occupancy and depreciation expenses;
- Costs associated with returns and exchanges; and
- Estimated costs to service customer warranty claims.

Sales & Marketing

- Advertising, marketing and media production;
- Marketing and selling materials such as brochures, videos, websites, customer mailings and in-store signage;
- Payroll and benefits for sales and customer service staff;
- Store occupancy costs;
- Store depreciation expense;
- Credit card processing fees; and
- Promotional financing costs.

G&A

- Payroll and benefit costs for corporate employees, including information technology, legal, human resources, finance, sales and marketing administration, investor relations and risk management;
- Occupancy costs of corporate facilities;
- Depreciation related to corporate assets;
- Information hardware, software and maintenance;
- Insurance;
- Investor relations costs; and
- Other overhead costs.

R&D[1]

- Internal labor and benefits related to research and development activities;
- Outside consulting services related to research and development activities; and
- Testing equipment related to research and development activities.

(1) Costs incurred in connection with R&D are charged to expense as incurred.

Operating 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. Our retail store leases generally provide for an initial lease term of five to 10 years. In addition, our mall-based retail store leases may require payment of contingent rent based on net sales in excess of certain thresholds. Certain retail store leases may contain options to extend the term of the original lease.

Minimum rent expense, which excludes contingent rents, is recognized on a straight-line basis over the lease term, after consideration of rent escalations and rent holidays. We record any difference between the straight-line rent amounts and amounts payable under the leases as part of deferred rent, in other current liabilities or other non-current liabilities, as appropriate. The lease term for 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. At December 30, 2017, and December 31, 2016, deferred rent included in other current liabilities in our consolidated balance sheets was $1 million and $0.2 million, respectively, and deferred rent included in other non-current liabilities in our consolidated balance sheets was $10 million and $10 million, respectively. Contingent rent expense is recorded when it is probable the expense has been incurred and the amount is reasonably estimable. Future payments for real estate taxes and certain building operating expenses for which we are obligated are not included in minimum lease payments.

Leasehold improvements that are funded by landlord incentives or allowances under an operating lease are recorded as deferred lease incentives, in other current liabilities or other non-current liabilities, as appropriate and amortized as reductions to rent expense over the lease term. At December 30, 2017, and December 31, 2016, deferred lease incentives included in other current liabilities in our consolidated balance sheets were $3 million and $3 million, respectively, and deferred lease incentives included in other non-current liabilities in our consolidated balance sheets were $10 million and $9 million, respectively.

Pre-Opening Costs

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

Advertising Costs

We incur advertising costs associated with print, digital and broadcast advertisements. Advertising costs are charged to expense when the ad first runs. Advertising expense was $194 million, $190 million and $181 million in 2017, 2016 and 2015, respectively. Advertising costs deferred and included in prepaid expenses in our consolidated balance sheets were $2 million and $1 million as of December 30, 2017, and December 31, 2016, respectively.

Insurance

We are self-insured for certain losses related to health and workers' compensation claims, although we obtain third-party insurance coverage to limit exposure to these claims. We estimate our self-insured liabilities using a number of factors including historical claims experience and analysis of incurred but not reported claims. Our self-insurance liability was $8 million and $6 million at December 30, 2017, and December 31, 2016, respectively. At December 30, 2017, and December 31, 2016, $5 million and $3 million, respectively, were included in compensation and benefits in our consolidated balance sheets and $3 million and $3 million, respectively, were included in other non-current liabilities in our consolidated balance sheets.

Software Capitalization

For software developed or obtained for internal use, we capitalize direct external costs associated with developing or obtaining internal-use software. In addition, we capitalize certain payroll and payroll-related costs for employees who are directly involved with the development of such applications. Capitalized costs related to internal-use software under development are treated as construction-in-progress until the program, feature or functionality is ready for its intended use, at which time depreciation commences. We expense any data conversion or training costs as incurred.

Stock-Based Compensation

We compensate officers, directors and key employees with stock-based compensation under two stock plans approved by our shareholders in 2004 and 2010 and administered under the supervision of our Board of Directors (Board). At December 30, 2017, a total of 2.6 million shares were available for future grant under the 2010 stock plan. These plans include non-qualified stock options and stock awards.

We record stock-based compensation expense based on the award's fair value at the grant date and the awards that are expected to vest. We recognize stock-based compensation expense over the period during which an employee is required to provide services in exchange for the award. We reduce compensation expense by estimated forfeitures. Forfeitures are estimated using historical experience and projected employee turnover. Beginning in 2017, we include, as part of cash flows from operating activities, the benefit of tax deductions in excess of recognized stock-based compensation expense. In addition, excess tax benefits or deficiencies that in prior years were recorded in additional paid-in capital are now recorded as discrete adjustments to income tax expense. See "*New Accounting Pronouncements*" below regarding revised guidance for stock-based compensation in 2017.

Stock Options - stock option awards are granted at exercise prices equal to the closing price of our stock on the grant date. Generally, options vest proportionally over three years and expire after 10 years. Compensation expense is recognized ratably over the vesting period.

We determine the fair value of stock options granted and the resulting compensation expense at the date-of-grant using the Black-Scholes-Merton option-pricing model. Descriptions of significant assumptions used to estimate the expected volatility, risk-free interest rate and expected term are as follows:

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

Risk-Free Interest Rate – the risk-free interest rate was based on the implied yield available on U.S. Treasury zero-coupon issues at the date of grant with a term equal to the expected term.

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

Stock Awards - we issue stock awards to certain employees in conjunction with our stock-based compensation plan. The stock awards generally vest over three years based on continued employment (time-based). Compensation expense related to stock awards, except for stock awards with a market condition, is determined on the grant date based on the publicly quoted closing price of our common stock and is charged to earnings on a straight-line basis over the vesting period. Stock awards with a market condition are valued using a Monte Carlo simulation model. The significant assumptions used to estimate the expected volatility and risk-free interest rate are similar to those described above in *Stock Options.*

Certain time-based stock awards have a performance condition (performance-based). The final number of shares earned for performance-based stock awards and the related compensation expense is adjusted up or down to the extent the performance target is met as of the last day of the performance period. The actual number of shares that will ultimately be awarded range from 0% - 200% of the targeted amount for the 2017, 2016 and 2015 awards. We evaluate the likelihood of meeting the performance targets at each reporting period and adjust compensation expense, on a cumulative basis, based on the expected achievement of each of the performance targets. For performance-based stock awards granted in 2017, 2016 and 2015, the performance targets are growth in net sales and in operating profit, and the performance periods are fiscal 2017 through 2019, fiscal 2016 through 2018, and 2015 through 2017, respectively.

See Note 9, *Shareholders' Equity*, for additional information on stock-based compensation.

Income Taxes

We recognize deferred tax assets and liabilities for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established for any portion of deferred tax assets that are not considered more likely than not to be realized. We evaluate all available positive and negative evidence, including our forecast of future taxable income, to assess the need for a valuation allowance on our deferred tax assets.

We record a liability for unrecognized tax benefits from uncertain tax positions taken, or expected to be taken, in our tax returns. We follow a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments, and may not accurately forecast actual outcomes.

We classify net interest and penalties related to income taxes as a component of income tax expense in our consolidated statements of operations.

Net Income Per Share

We calculate basic net income per share by dividing net income by the weighted-average number of common shares outstanding during the period. We calculate diluted net income per share based on the weighted-average number of common shares outstanding adjusted by the number of potentially dilutive common shares as determined by the treasury stock method. Potentially dilutive shares consist of stock options and stock awards.

Sources of Supply

We currently obtain materials and components used to produce our beds from outside sources. As a result, we are dependent upon suppliers that in some instances, are our sole source of supply. We are continuing our efforts to dual-source key components. The failure of one or more of our suppliers to provide us with materials or components on a timely basis could significantly impact our consolidated results of operations and net income per share. We believe we can obtain these raw materials and components from other sources of supply in the ordinary course of business, although an unexpected loss of supply over a short period of time may not allow us to replace these sources in the ordinary course of business.

New Accounting Pronouncements

<u>Recently Adopted Accounting Guidance</u>

In March 2016, the Financial Accounting Standards Board (FASB) issued new guidance on the accounting for, and disclosure of, stock-based compensation which we adopted effective January 1, 2017. The new guidance is intended to simplify several aspects of the accounting for stock-based compensation arrangements, including the income tax impact, forfeitures and classification on the statement of cash flows. Under the previous guidance, excess tax benefits and deficiencies were recognized in additional paid-in capital in the consolidated balance sheets. Upon adoption of the new guidance, these excess tax benefits or deficiencies are required to be recognized as discrete adjustments to income tax expense in the consolidated statements of operations on a prospective basis. During fiscal 2017, excess tax benefits of $1.4 million were recognized as a reduction of income tax expense, rather than in additional paid-in capital.

In addition, under the new guidance, excess income tax benefits from stock-based compensation arrangements are classified as an operating activity in the statement of cash flows rather than as a financing activity. This resulted in an increase to operating cash flows of $2.3 million for fiscal 2017. We elected to apply the new cash flow classification guidance prospectively. The prior-years' statements of cash flows have not been adjusted. We have also elected to continue to estimate the number of stock-based awards expected to vest, as permitted by the new guidance, rather than electing to account for forfeitures as they occur.

Accounting Guidance Issued but Not Yet Adopted as of December 30, 2017

In May 2014, the FASB issued a comprehensive new revenue recognition model that requires a company to recognize revenue in a manner that depicts the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. This new guidance will be effective for us beginning December 31, 2017 and we will use the modified retrospective transition method. Under this method, we will recognize the cumulative effect of the changes in retained earnings at December 31, 2017, but will not restate prior periods.

We have substantially completed our evaluation of the impact of the new revenue recognition standard on our consolidated financial statements and have determined that the transition adjustments to be recorded upon adoption are not material and we do not expect material changes in the timing of revenue recognition. We continue to evaluate the impact of the new standard on our disclosures. We also expect that the adoption and changes to our ongoing procedures and methodologies will require adjustments to our internal controls over financial reporting.

In February 2016, the FASB issued new guidance on accounting for leases that generally requires most leases to be recognized on the balance sheet. This new guidance is effective for reporting periods beginning after December 15, 2018. The provisions of this new guidance are to be applied using a modified retrospective approach, with elective reliefs, which requires application of the new guidance for all periods presented. We are evaluating the effect of the new standard on our consolidated financial statements and related disclosures. We are the lessee under various agreements for facilities and equipment that are currently accounted for as operating leases. A discussion of our operating leases is included in Note 1, *Business and Summary of Significant Accounting Policies,* and Note 7, *Leases*. This new guidance is effective for us beginning December 30, 2018.

(2) Acquisition of BAM Labs, Inc.

In September 2015, we completed the acquisition of BAM Labs, Inc. (now operating as SleepIQ LABS), the leading provider of biometric sensor and sleep monitoring for data-driven health and wellness. The addition of SleepIQ LABS strengthened Sleep Number's leadership in sleep innovation, adjustability and individualization. The acquisition broadened and deepened our electrical, biomedical, software and backend capabilities - API (application program interface), and bio-signal analysis. Our ownership and control of biometric data advances smart, connected products that empower our customers with the knowledge to adjust for their best sleep.

We previously held a $6 million minority equity investment in BAM Labs, Inc. based on the cost method. We acquired the remaining capital stock of BAM Labs, Inc. for $57 million for a total enterprise value of $70 million. In connection with the acquisition, our equity investment was remeasured to a fair value of $13 million resulting in a $4 million gain net of expenses, including $3 million of acquisition-related expenses. The remeasured fair value of our equity investment was based on the fair value of BAM Labs, Inc. at the acquisition date. The net gain of $4 million was included in general and administrative expenses on our consolidated statement of operations for the year ended January 2, 2016. The acquisition of SleepIQ LABS did not have a significant impact on our consolidated results of operations, operating cash flows or financial position for the years ended December 30, 2017, December 31, 2016 or January 2, 2016.

The following table summarizes the fair value of the net assets acquired as of the acquisition date (in thousands):

Accounts receivable	$ 105
Prepaid expenses	98
Property and equipment	91
Deferred income taxes	2,754
Goodwill	55,083
Intangible assets	13,619
Total assets acquired	71,750
Accounts payable	269
Compensation and benefits	322
Other non-current liabilities	1,141
Total liabilities acquired	1,732
Net assets acquired	$ 70,018

Intangible assets of $14 million consisted of developed technologies with an estimated useful life of eight years. The goodwill will not be deductible for income tax purposes.

(3) Fair Value Measurements

At December 30, 2017 and December 31, 2016, we had $4 million and $2 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 $4 million and $2 million at December 30, 2017 and December 31, 2016, 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.

(4) Inventories

Inventories consisted of the following (in thousands):

	December 30, 2017	December 31, 2016
Raw materials	$ 6,577	$ 7,973
Work in progress	170	72
Finished goods	77,551	66,981
	$ 84,298	$ 75,026

Our finished goods inventory, as of December 30, 2017, was comprised of $25 million of finished beds, including retail display beds and deliveries in-transit to those customers who have utilized home delivery services, $35 million of finished components that were ready for assembly for the completion of beds, and $18 million of retail accessories.

Our finished goods inventory, as of December 31, 2016, was comprised of $21 million of finished beds, including retail display beds and deliveries in-transit to those customers who have utilized home delivery services, $29 million of finished components that were ready for assembly for the completion of beds, and $17 million of retail accessories.

(5) Property and Equipment

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

	December 30, 2017	December 31, 2016
Land	$ 1,999	$ 1,999
Leasehold improvements	102,495	97,600
Furniture and equipment	94,265	81,541
Production machinery, computer equipment and software	224,758	209,900
Construction in progress	5,661	13,823
Less: Accumulated depreciation and amortization	(220,532)	(196,496)
	$ 208,646	$ 208,367

(6) Goodwill and Intangible Assets, Net

Goodwill and Indefinite-Lived Intangible Assets

Goodwill was $64 million at December 30, 2017 and December 31, 2016. Indefinite-lived trade name/trademarks totaled $1.4 million at December 30, 2017 and December 31, 2016.

Definite-Lived Intangible Assets

The following table provides the gross carrying amount and related accumulated amortization of our definite-lived intangible assets (in thousands):

	December 30, 2017		December 31, 2016	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Developed technologies	$ 18,851	$ 6,705	$ 18,851	$ 4,524
Customer relationships	2,413	2,413	2,413	1,365
Trade names/trademarks	101	101	101	101
	$ 21,365	$ 9,219	$ 21,365	$ 5,990

Amortization expense in 2017, 2016 and 2015 for definite-lived intangible assets was $3 million, $2 million and $1 million, respectively. Annual amortization for definite-lived intangible assets is expected to be approximately $2 million for 2018 through 2022.

(7) Leases

Rent expense was as follows (in thousands):

	2017	2016	2015
Facility Rents:			
Minimum rents	$ 66,239	$ 59,002	$ 52,650
Contingent rents	2,845	3,099	5,168
Total	$ 69,084	$ 62,101	$ 57,818
Equipment Rents	$ 4,935	$ 5,316	$ 4,362

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

2018	$ 70,604
2019	65,114
2020	58,069
2021	52,284
2022	45,657
Thereafter	145,039
Total future minimum lease payments	$ 436,767

(8) Credit Agreement

Our revolving credit facility as of December 30, 2017 had a net aggregate availability of $153 million. The credit facility is for general corporate purposes and is also utilized 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 and a minimum interest coverage ratio. Under the terms of the credit agreement we pay a variable rate of interest and a commitment fee based on our leverage ratio.

As of December 30, 2017, we had $25 million in outstanding borrowings and $3 million in outstanding letters of credit. We had additional borrowing capacity of $125 million. As of December 30, 2017, the weighted-average interest rate on borrowings outstanding under the credit facility was 3.1% and we were in compliance with all financial covenants.

In February 2018, we amended our revolving credit facility (Credit Agreement, as amended) to increase our net aggregate availability from $153 million to $300 million. We maintained the accordion feature which allows us to increase the amount of the credit facility from $300 million to $450 million, subject to Lenders' approval. The Credit Agreement, as amended, matures in February 2023. There were no other significant changes to the Credit Agreement's terms and conditions.

(9) Shareholders’ Equity

Stock-Based Compensation Expense

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

	2017	2016	2015
Stock options	$ 2,344	$ 2,281	$ 2,634
Stock awards	13,419	9,680	7,656
Total stock-based compensation expense	15,763	11,961	10,290
Income tax benefit	5,249	3,947	3,413
Total stock-based compensation expense, net of tax	$ 10,514	$ 8,014	$ 6,877

Stock Options

A summary of our stock option activity was as follows (in thousands, except per share amounts and years):

	Stock Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value [1]
Balance at December 31, 2016	1,354	$ 18.70	5.9	$ 7,541
Granted	262	24.26		
Exercised	(222)	14.58		
Canceled/Forfeited	(39)	26.17		
Outstanding at December 30, 2017	1,355	$ 20.23	6.2	$ 23,515
Exercisable at December 30, 2017	879	$ 18.79	4.8	$ 16,533
Vested and expected to vest at December 30, 2017	1,321	$ 20.16	6.1	$ 23,023

(1) Aggregate intrinsic value includes only those options where the current share price is equal to or greater than the share price on the date of grant.

Other information pertaining to options was as follows (in thousands, except per share amounts):

	2017	2016	2015
Weighted-average grant date fair value of stock options granted	$ 10.33	$ 8.85	$ 15.94
Total intrinsic value (at exercise) of stock options exercised	$ 3,586	$ 2,088	$ 4,592

Cash received from the exercise of stock options for the fiscal year ended December 30, 2017 was $3.2 million. Our tax benefit related to the exercise of stock options for the fiscal year ended December 30, 2017 was $1.3 million.

At December 30, 2017, there was $2.8 million of total stock option compensation expense related to non-vested stock options not yet recognized, which is expected to be recognized over a weighted-average period of 1.8 years.

During 2016, 30,500 market-based stock options were granted and had a weighted-average grant date fair value of $10.25 per option. These options are reflected in the stock option activity table above. There were no market-based stock options granted in 2015 or 2017. The assumptions used to calculate the fair value of market-based stock options granted using the Monte Carlo simulation model were as follows:

Valuation Assumptions	2017	2016	2015
Expected dividend yield	NA	0%	NA
Expected volatility	NA	50%	NA
Risk-free interest rate	NA	1.8%	NA

Except for the market-based stock options discussed above, the fair value of options granted was calculated using the Black-Scholes-Merton option-pricing model.

The assumptions used to calculate the fair value of options granted using the Black-Scholes-Merton option-pricing model were as follows:

Valuation Assumptions	2017	2016	2015
Expected dividend yield	0%	0%	0%
Expected volatility	46%	50%	54%
Risk-free interest rate	2.0%	1.4%	1.6%
Expected term (in years)	5.1	5.2	5.2

Stock Awards

Stock award activity was as follows (in thousands, except per share amounts):

	Time-Based Stock Awards	Weighted-Average Grant Date Fair Value	Performance- and Market-Based Stock Awards	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2016	530	$20.83	899	$20.87
Granted	217	25.81	568	23.03
Vested	(312)	20.35	(338)	16.73
Canceled/Forfeited	(40)	22.47	(66)	19.88
Outstanding at December 30, 2017	395	$23.77	1,063	$23.41

At December 30, 2017, there was $5.5 million of unrecognized compensation expense related to non-vested time-based stock awards, which is expected to be recognized over a weighted-average period of 1.8 years and $15.2 million of unrecognized compensation expense related to non-vested performance-based and market-based stock awards, which is expected to be recognized over a weighted-average period of 2.1 years.

During 2017, 270,895 performance-based stock awards with a market condition were granted and had a weighted-average grant date fair value of $22.40 per award. These stock awards are reflected in the "Performance- and Market-Based Stock Awards" column in the stock award activity table above. There were no market-based stock awards granted in 2016 or 2015. The assumptions used to calculate the fair value of the 2017 performance-base stock awards with a market condition, using the Monte Carlo simulation model, were as follows:

Valuation Assumptions	2017	2016	2015
Expected dividend yield	0%	NA	NA
Expected volatility	46%	NA	NA
Risk-free interest rate	1.5%	NA	NA

Repurchases of Common Stock

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

	2017	2016	2015
Amount repurchased under Board-approved share repurchase program	$ 150,000	$ 125,000	$ 98,446
Amount repurchased in connection with the vesting of employee restricted stock grants	5,245	1,693	1,755
Total amount repurchased	$ 155,245	$ 126,693	$ 100,201

Effective as of October 1, 2017, our Board approved an increase in our total remaining share repurchase authorization to $500 million. As of December 30, 2017, the remaining authorization under our Board-approved share repurchase program was $465 million. There is no expiration date governing the period over which we can repurchase shares. Any repurchased shares are constructively retired and returned to an unissued status. The cost of stock repurchases is first charged to additional paid-in-capital. Once additional paid-in capital is reduced to zero, any additional amounts are charged to retained earnings.

Net Income per Common Share

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

	2017	2016	2015
Net income	$ 65,077	$ 51,417	$ 50,519
Reconciliation of weighted-average shares outstanding:			
Basic weighted-average shares outstanding	41,212	46,154	51,252
Dilutive effect of stock-based awards	873	748	849
Diluted weighted-average shares outstanding	42,085	46,902	52,101
Net income per share – basic	$ 1.58	$ 1.11	$ 0.99
Net income per share – diluted	$ 1.55	$ 1.10	$ 0.97

Additional potential dilutive stock options totaling 0.4 million, 0.6 million and 0.4 million for 2017, 2016 and 2015, respectively, have been excluded from our diluted net income per share calculations because these securities' exercise prices were anti-dilutive (e.g., greater than the average market price of our common stock).

(10) Other (Expense) Income, Net

Other (expense) income, net, consisted of the following (in thousands):

	2017	2016	2015
Interest expense	$ (975)	$ (811)	$ (160)
Interest income	98	94	$ 494
Other (expense) income, net	$ (877)	$ (717)	$ 334

(11) Income Taxes

Income tax expense consisted of the following (in thousands):

	2017	2016	2015
Current:			
Federal	$ 19,153	$ 21,634	$ 7,272
State	4,046	5,289	3,870
	23,199	26,923	11,142
Deferred:			
Federal	2,734	(105)	13,567
State	28	(2,302)	202
	2,762	(2,407)	13,769
Income tax expense	$ 25,961	$ 24,516	$ 24,911

The following table provides a reconciliation between the statutory federal income tax rate and our effective income tax rate:

	2017	2016	2015
Statutory federal income tax	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.5	2.6	3.0
Manufacturing deduction	(3.5)	(3.3)	(1.7)
Effect of 2018 deferred tax rate change	(1.9)	—	—
Changes in unrecognized tax benefits	(0.6)	1.2	0.3
Non-taxable acquisition-related transactions	—	—	(2.6)
Other	(3.0)	(3.2)	(1.0)
Effective income tax rate	28.5%	32.3%	33.0%

We file income tax returns with the U.S. federal government and various state jurisdictions. In the normal course of business, we are subject to examination by federal and state taxing authorities. We are no longer subject to federal income tax examinations for years prior to 2014 or state income tax examinations prior to 2013.

On December 22, 2017, the Tax Cuts and Jobs Act (TCJA) was enacted. The TCJA reduces the statutory federal tax rate from 35% to 21% starting in 2018. In addition, there were various other tax law changes that impacted us. In connection with the reduction of the federal tax rate, we recognized a provisional tax benefit of $1.7 million for the year ended December 30, 2017. This provisional tax benefit is related to the re-measurement of U.S. deferred tax assets and liabilities using a federal tax rate of 21%, which, under the TCJA, is expected to be in place when such deferred assets and liabilities reverse in future periods.

The other provisions of the TCJA did not have a significant impact on our consolidated financial statements for the year ended December 30, 2017, but may impact our effective tax rate in subsequent periods.

The TCJA has significant complexity and our final tax liability may differ from these estimates, due to, among other things, guidance that may be issued by the U.S. Treasury Department and the Internal Revenue Service, and related interpretations and clarifications of tax law. For the re-measurement of the deferred tax assets and liabilities, further analysis may be required to refine our calculations and related account balances.

We will complete the remaining elements of our analysis during 2018, and any adjustments to the provisional tax benefit will be included in income tax expense in the appropriate period, in accordance with the U.S. generally accepted accounting principles.

Deferred Income Taxes

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

	2017	2016
Deferred tax assets:		
Stock-based compensation	$ 6,940	$ 9,834
Deferred rent and lease incentives	6,007	8,388
Warranty and returns liabilities	6,602	7,948
Net operating loss carryforwards and credits	3,240	6,368
Compensation and benefits	3,315	4,115
Other	3,321	5,264
Total gross deferred tax assets	29,425	41,917
Valuation allowance	(615)	(620)
Total deferred tax assets after valuation allowance	28,810	41,297
Deferred tax liabilities:		
Property and equipment	21,475	27,049
Deferred revenue	723	3,279
Other	3,987	6,302
Total gross deferred tax liabilities	26,185	36,630
Net deferred tax assets	$ 2,625	$ 4,667

At December 30, 2017, we had net operating loss carryforwards for federal purposes of $3 million, which will expire between 2025 and 2034, and for state income tax purposes of $6 million, which will expire between 2028 and 2037.

We evaluate our deferred income taxes quarterly to determine if valuation allowances are required. As part of this evaluation, we assess whether valuation allowances should be established for any deferred tax assets that are not considered more likely than not to be realized, using all available evidence, both positive and negative. This assessment considers, among other matters, the nature, frequency, and severity of historical losses, forecasts of future profitability, taxable income in available carryback periods and tax planning strategies. In making such judgments, significant weight is given to evidence that can be objectively verified. We have provided a $0.6 million valuation allowance resulting primarily from our inability to utilize certain foreign net operating losses, and federal net operating losses associated with our acquisition of BAM Labs, Inc.

Unrecognized Tax Benefits

Reconciliations of the beginning and ending amounts of unrecognized tax benefits for 2017, 2016 and 2015 were as follows (in thousands):

	Federal and State Tax		
	2017	2016	2015
Beginning balance	$ 3,460	$ 2,077	$ 742
Increases related to current-year tax positions	330	326	1,277
Increases related to prior-year tax positions	87	1,594	113
Decreases related to prior-year tax positions	(1,038)	—	—
Lapse of statute of limitations	—	(333)	(55)
Settlements with taxing authorities	—	(204)	—
Ending balance	$ 2,839	$ 3,460	$ 2,077

As of December 30, 2017 and December 31, 2016, we had $3 million and $4 million, respectively, of unrecognized tax benefits, which if recognized, would affect our effective tax rate. The amount of unrecognized tax benefits is not expected to change materially within the next 12 months.

(12) 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 year, we may make a discretionary contribution equal to a percentage of the employee's contribution. During 2017, 2016 and 2015, our contributions, net of forfeitures, were $5 million, $5 million and $4 million, respectively.

(13) Commitments and Contingencies

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 generally accepted accounting principles in the United States, 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. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible additional losses either because we believe that we have valid defenses to claims asserted against us or the proceeding has not advanced to a stage of discovery that would enable us to establish an estimate. We currently do not expect the outcome of these matters 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 January 12, 2015, Plaintiffs David and Katina Spade commenced a purported class action lawsuit in New Jersey state court against Sleep Number alleging that Sleep Number violated New Jersey consumer statutes by failing to provide to purchasing consumers certain disclosures required by the New Jersey Furniture Regulations. It is undisputed that plaintiffs suffered no actual damages or in any way relied upon or were impacted by the alleged omissions. Nonetheless, on behalf of a purported class of New Jersey purchasers of Sleep Number beds and bases, plaintiffs seek to recover a $100 statutory fine for each alleged omission, along with attorneys' fees and costs. Sleep Number removed the case to the United States District Court for the District of New Jersey, which subsequently granted Sleep Number's motion to dismiss. Plaintiffs appealed to the United States Court of Appeals for the Third Circuit, which has certified two questions of law to the New Jersey Supreme Court relating to whether plaintiffs who have suffered no actual injury may bring claims. The New Jersey Supreme Court has accepted the certified questions and oral arguments were heard in November 2017. As the United States District Court for the District of New Jersey determined, we believe that the case is without merit and the order of dismissal should be affirmed.

Consumer Credit Arrangements

We refer customers seeking extended financing to certain third party financiers (Card Servicers). The Card Servicers, if credit is granted, establish the interest rates, fees, and all other terms and conditions of the customer's account based on their evaluation of the creditworthiness of the customer. As the receivables are owned by the Card Servicers, at no time are the receivables purchased or acquired from us. We are not liable to the Card Servicers for our customers' credit defaults.

Commitments

As of December 30, 2017, we had $9 million of inventory purchase commitments. As part of the normal course of business, there are a limited number of inventory supply contracts that contain penalty provisions for failure to purchase contracted quantities. We do not currently expect any payments under these provisions. At December 30, 2017, we had entered into 38 lease commitments for future retail store locations. These lease commitments provide for minimum rentals over the next five to 10 years, which if consummated based on current cost estimates, would approximate $54 million over the initial lease term. The minimum rentals for these lease commitments have been included in the future minimum lease payments in Note 7, *Leases*.

(14) Summary of Quarterly Financial Data (unaudited)

The following is a condensed summary of our quarterly results (in thousands, except net income (loss) per share amounts). Quarterly diluted net income (loss) per share amounts may not total to the respective annual amount due to changes in weighted-average shares outstanding during the year.

2017	First	Second	Third	Fourth	Fiscal Year
Net sales	$ 393,899	$ 284,673	$ 402,646	$ 363,279	$ 1,444,497
Gross profit	246,459	176,619	253,465	220,804	897,347
Operating income (loss)	35,828	(3,061)	39,029	20,119	91,915
Net income (loss)	24,461	(778)	25,603	15,791	65,077
Net income (loss) per share – diluted	$ 0.56	$ (0.02)	$ 0.62	$ 0.39	$ 1.55

2016	First	Second	Third	Fourth	Fiscal Year
Net sales	$ 352,980	$ 276,878	$ 367,988	$ 313,445	$ 1,311,291
Gross profit	209,074	171,261	232,343	197,482	810,160
Operating income	19,898	2,396	39,044	15,312	76,650
Net income	12,969	1,416	25,745	11,287	51,417
Net income per share – diluted	$ 0.27	$ 0.03	$ 0.56	$ 0.25	$ 1.10

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

None

ITEM 9A. CONTROLS AND PROCEDURES

Conclusions Regarding the Effectiveness of Disclosure Controls and Procedures

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

Management's Report on Internal Control Over Financial Reporting

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

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

Sleep Number's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Management, with the participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation under these criteria, management concluded that our internal control over financial reporting was effective as of December 30, 2017. The report of Deloitte & Touche LLP, our independent registered public accounting firm, regarding the effectiveness of our internal control over financial reporting is included in this report in "Part II, Item 8, Financial Statements and Supplementary Data" under "Report of Independent Registered Public Accounting Firm."

Fourth Quarter Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information under the captions "Election of Directors," "Corporate Governance" and "Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement for our 2018 Annual Meeting of Shareholders is incorporated herein by reference. Information concerning our executive officers is included in Part I of this report under the caption "Executive Officers of the Registrant."

We have adopted a Code of Business Conduct applicable to our directors, officers and employees (including our principal executive officer, principal financial officer and principal accounting officer). The Code of Business Conduct is available on the Investor Relations section of our website at *www.SleepNumber.com. S*elect the "*Investors*" link, the "*Governance*" link and then the "*Documents & Charters*" link. In the event that we amend or waive any of the provisions of the Code of Business Conduct applicable to our principal executive officer, principal financial officer and principal accounting officer, we intend to disclose the same on our website at *www.SleepNumber.com*.

ITEM 11. EXECUTIVE COMPENSATION

The information under the caption "Executive Compensation" in our Proxy Statement for our 2018 Annual Meeting of Shareholders is incorporated herein by reference.

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

Stock Ownership

The information under the caption "Stock Ownership of Management and Certain Beneficial Owners" in our Proxy Statement for our 2018 Annual Meeting of Shareholders is incorporated herein by reference.

Securities Authorized for Issuance under Equity Compensation Plans

The information under the caption "Equity Compensation Plan Information" in our Proxy Statement for our 2018 Annual Meeting of Shareholders is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information under the caption "Corporate Governance" in our Proxy Statement for our 2018 Annual Meeting of Shareholders is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information under the caption "Ratification of Selection of Independent Registered Public Accounting Firm" in our Proxy Statement for our 2018 Annual Meeting of Shareholders is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Consolidated Financial Statements and Schedule

(1) Financial Statements

All financial statements as set forth under Item 8 of this report.

(2) Consolidated Financial Statement Schedule

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

Schedule II - Valuation and Qualifying Accounts

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

(3) Exhibits

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

We will furnish a copy of the exhibits referred to above at a reasonable cost to any shareholder upon receipt of a written request. Requests should be sent to: Sleep Number Corporation, Investor Relations Department, 1001 Third Avenue South, Minneapolis, MN 55404.

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

1. Select Comfort Corporation 2004 Stock Incentive Plan (Amended and Restated as of January 1, 2007)
2. Form of Nonstatutory Stock Option Award Agreement under the 2004 Stock Incentive Plan
3. Form of Restricted Stock Award Agreement under the 2004 Stock Incentive Plan
4. Form of Performance Stock Award Agreement under the 2004 Stock Incentive Plan
5. Form of Nonstatutory Stock Option Award Agreement (Subject to Performance Adjustment) under the 2004 Stock Incentive Plan
6. Select Comfort Corporation Amended and Restated 2010 Omnibus Incentive Plan
7. Form of Nonstatutory Stock Option Award Agreement under the 2010 Omnibus Incentive Plan
8. Form of Restricted Stock Award Agreement under the 2010 Omnibus Incentive Plan
9. Form of Performance Stock Award Agreement under the 2010 Omnibus Incentive Plan
10. Select Comfort Executive Investment Plan (December 1, 2014 Restatement)
11. Employment Offer Letter from Select Comfort Corporation to Shelly R. Ibach dated February 9, 2007
12. Employment Offer Letter from Select Comfort Corporation to David R. Callen dated March 14, 2014
13. Employment Offer Letter from Select Comfort Corporation to Mark A. Kimball dated April 22, 1999
14. Select Comfort Corporation Executive Physical Plan
15. Summary of Executive Tax and Financial Planning Program
16. Amended and Restated Select Comfort Corporation Executive Severance Pay Plan
17. First Amendment to Amended and Restated Select Comfort Corporation Executive Severance Pay Plan
18. Summary of Non-Employee Director Compensation

ITEM 16. FORM 10-K SUMMARY

Not applicable.

SLEEP NUMBER CORPORATION
EXHIBIT INDEX TO ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 30, 2017

Exhibit No.	Description	Method of Filing
3.1	Third Restated Articles of Incorporation of the Company, as amended	Incorporated by reference to Exhibit 3.1 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 1, 2000 (File No. 0-25121)
3.2	Articles of Amendment to Third Restated Articles of Incorporation of the Company	Incorporated by reference to Exhibit 3.1 contained in Sleep Number's Current Report on Form 8-K filed May 16, 2006 (File No. 0-25121)
3.3	Articles of Amendment to Third Restated Articles of Incorporation of the Company	Incorporated by reference to Exhibit 3.1 contained in Sleep Number's Current Report on Form 8-K filed May 25, 2010 (File No. 0-25121)
3.4	Restated Bylaws of the Company	Incorporated by reference to Exhibit 3.1 contained in Sleep Number's Current Report on Form 8-K filed May 22, 2017 (File No. 0-25121)
10.1	Lease Agreement dated September 9, 2015 between the Company and Truluck Industries, Inc.	Incorporated by reference to Exhibit 10.3 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended October 3, 2015 (File No. 0-25121)
10.2	Lease Agreement dated September 30, 1998 between the Company and ProLogis Development Services Incorporated	Incorporated by reference to Exhibit 10.28 contained in Sleep Number's Registration Statement on Form S-1, as amended, filed October 29, 1998 (Reg. No. 333-62793)
10.3	Second Amendment to Lease Agreement dated June 15, 2015 between the Company and CLFP - SLIC 8, L.P. (successor in interest to ProLogis Development Services Incorporated)	Incorporated by reference to Exhibit 10.4 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended October 3, 2015 (File No. 0-25121)
10.4	Lease Agreement between DCI 1001 Minneapolis Venture, LLC, as Landlord, and Sleep Number Corporation, as Tenant, dated October 21, 2016	Incorporated by reference to Exhibit 10.12 contained in Sleep Number’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (File No. 0-25121)
10.5	First Amendment, dated June 22, 2017, to Lease Agreement between DCI 1001 Minneapolis Venture, LLC, as Landlord, and Sleep Number Corporation, as Tenant, dated October 21, 2016	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended July 1, 2017 (File No. 0-25121)
10.6	Sleep Number Corporation 2004 Stock Incentive Plan (Amended and Restated as of January 1, 2007)	Incorporated by reference to Exhibit 10.16 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 30, 2006 (File No. 0-25121)
10.7	Form of Nonstatutory Stock Option Award Agreement under the Sleep Number Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.28 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)

Exhibit No.	Description	Method of Filing
10.8	Form of Restricted Stock Award Agreement under the Sleep Number Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.29 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.9	Form of Performance Stock Award Agreement under the Sleep Number Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.30 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (File No. 0-25121)
10.10	Form of Nonstatutory Stock Option Award Agreement (Subject to Performance Adjustment) under the Sleep Number Corporation 2004 Stock Incentive Plan	Incorporated by reference to Exhibit 10.20 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 30, 2006 (File No. 0-25121)
10.11	Sleep Number Corporation Amended and Restated 2010 Omnibus Incentive Plan	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Current Report on Form 8-K filed May 15, 2013 (File No. 0-25121)
10.12	Form of Nonstatutory Stock Option Award Agreement under the 2010 Omnibus Incentive Plan	Incorporated by reference to Exhibit 10.20 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 1, 2011 (File No. 0-25121)
10.13	Form of Restricted Stock Award Agreement under the 2010 Omnibus Incentive Plan	Incorporated by reference to Exhibit 10.21 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 1, 2011 (File No. 0-25121)
10.14	Form of Performance Stock Award Agreement under the 2010 Omnibus Incentive Plan	Incorporated by reference to Exhibit 10.22 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 1, 2011 (File No. 0-25121)
10.15	Form of Performance-Based Restricted Stock Unit Award Agreement - EPS Target	Incorporated by reference to Exhibit 10.2 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended April 1, 2017 (File No. 0-25121)
10.16	Sleep Number Executive Investment Plan (December 1, 2014 Restatement)	Incorporated by reference to Exhibit 10.21 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 3, 2015 (File No. 0-25121)
10.17	Employment Offer Letter from Sleep Number Corporation to Shelly R. Ibach dated February 9, 2007	Incorporated by reference to Exhibit 10.30 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 29, 2012 (File No. 0-25121)
10.18	Employment Offer Letter from Sleep Number Corporation to David R. Callen dated March 14, 2014	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Current Report on Form 8-K filed March 20, 2014 (File No. 0-25121)
10.19	Employment Offer Letter from Sleep Number Corporation to Mark A. Kimball dated April 22, 1999	Incorporated by reference to Exhibit 10.25 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 1, 2000 (File No. 0-25121)

Exhibit No.	Description	Method of Filing
10.20	Sleep Number Corporation Executive Physical Plan	Incorporated by reference to Exhibit 10.27 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 3, 2015 (File No. 0-25121)
10.21	Summary of Executive Tax and Financial Planning Program	Incorporated by reference to Exhibit 10.27 contained in Sleep Number’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (File No. 0-25121)
10.22	Amended and Restated Sleep Number Corporation Executive Severance Pay Plan	Incorporated by reference to Exhibit 10.2 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended July 1, 2017 (File No. 0-25121)
10.23	Summary of Non-Employee Director Compensation	Incorporated by reference to Exhibit 10.30 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended January 2, 2016 (File No. 0-25121)
10.24	Master Supply Agreement dated July 16, 2013 between the Company and Supplier (1)	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended September 28, 2013 (File No. 0-25121)
10.25	Retailer Program Agreement effective as of January 1, 2014 by and between Synchrony Bank, Sleep Number Corporation and Select Comfort Retail Corporation (1)	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended June 28, 2014 (File No. 0-25121)
10.26	First Amendment to Retailer Program Agreement, dated effective as of October 1, 2014 by and between Synchrony Bank, Sleep Number Corporation and Select Comfort Retail Corporation	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Current Report on Form 8-K filed October 1, 2014 (File No. 0-25121)
10.27	Second Amendment to Retailer Program Agreement, dated November 4, 2015 by and between Synchrony Bank, Sleep Number Corporation and Select Comfort Retail Corporation (1)	Incorporated by reference to Exhibit 10.5 contained in Sleep Number's Quarterly Report on Form 10-Q for the quarter ended October 3, 2015 (File No. 0-25121)
10.28	Sleep Number Corporation Non-Employee Director Deferral Plan	Incorporated by reference to Exhibit 10.1 contained in Sleep Number's Current Report on Form 8-K filed September 16, 2011 (File No. 0-25121)
10.29	Amended and Restated Credit and Security Agreement, dated as of February 14, 2018 among Sleep Number Corporation, U.S. Bank National Association and the several banks and other financial institutions from time to time party thereto.	Filed herewith
21.1	Subsidiaries of the Company	Filed herewith
23.1	Consent of Independent Registered Public Accounting Firm	Filed herewith
24.1	Power of Attorney	Included on signature page
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith

Exhibit No.	Description	Method of Filing
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350	Furnished herewith(2)
32.2	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350	Furnished herewith(2)
101	The following financial information from the Company's Annual Report on Form 10-K for the period ended December 30, 2017, filed with the SEC on February 27, 2018, formatted in eXtensible Business Reporting Language: (i) Consolidated Balance Sheets as of December 30, 2017 and December 31, 2016; (ii) Consolidated Statements of Operations for the years ended December 30, 2017, December 31, 2016 and January 2, 2016; (iii) Consolidated Statements of Comprehensive Income for the years ended December 30, 2017, December 31, 2016 and January 2, 2016; (iv) Consolidated Statements of Shareholders' Equity for the years ended December 30, 2017, December 31, 2016 and January 2, 2016; (v) Consolidated Statements of Cash Flows for the years ended December 30, 2017, December 31, 2016 and January 2, 2016; and (vi) Notes to Consolidated Financial Statements.	Filed herewith

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

(2) This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Act of 1934, as amended, (15 U.S.C. 78r) or otherwise subject to the liability of that section. Such exhibit will not be deemed to be incorporated by reference into any document filed under the Securities Act of 1933, as amended, or under the Securities Exchange Act of 1934, as amended, except as otherwise expressly stated in any such filing.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: February 27, 2018

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

By: /s/ David R. Callen
David R. Callen
Chief Financial Officer
(principal financial officer)

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

POWER OF ATTORNEY

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

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

Name	Title	Date
/s/ Jean-Michel Valette Jean-Michel Valette	Chairman of the Board	February 21, 2018
/s/ Shelly R. Ibach Shelly R. Ibach	Director	February 26, 2018
/s/ Daniel I. Alegre Daniel I. Alegre	Director	February 21, 2018
/s/ Stephen L. Gulis, Jr. Stephen L. Gulis, Jr.	Director	February 26, 2018
/s/ Michael J. Harrison Michael J. Harrison	Director	February 23, 2018
/s/ Brenda J. Lauderback Brenda J. Lauderback	Director	February 24, 2018
/s/ Barbara R. Matas Barbara R. Matas	Director	February 23, 2018
/s/ Kathleen L. Nedorostek Kathleen L. Nedorostek	Director	February 26, 2018
/s/ Vicki A. O'Meara Vicki A. O'Meara	Director	February 25, 2018
/s/ Michael A. Peel Michael A. Peel	Director	February 26, 2018

SLEEP NUMBER CORPORATION AND SUBSIDIARIES
Schedule II - Valuation and Qualifying Accounts
(in thousands)

Description	2017	2016	2015
Allowance for doubtful accounts			
Balance at beginning of period	$ 884	$ 1,039	$ 739
Additions charged to costs and expenses	915	1,224	1,577
Deductions from reserves	(1,085)	(1,379)	(1,277)
Balance at end of period	$ 714	$ 884	$ 1,039
Accrued sales returns			
Balance at beginning of period	$ 15,222	$ 20,562	$ 15,262
Additions charged to costs and expenses	77,226	71,958	84,265
Deductions from reserves	(73,178)	(77,298)	(78,965)
Balance at end of period	$ 19,270	$ 15,222	$ 20,562

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