Proxy Statement and Annual Report

Sleep Number Corporation

2019 Annual Meeting

sleep number.

Dear Shareholders,

Sleep Number's mission of improving lives by individualizing sleep experiences is at the core of our purpose-driven company. To date, we have improved the lives of more than eleven and a half million people. Our consumer innovation strategy translates directly to increased shareholder value. Over the past five years, our strategic consistency, profitable investments, and sleep innovations have generated total shareholder returns of 144% through March 1st, 2019.

We have prioritized approximately $500 million in investments since 2012 to strengthen our competitive advantages of proprietary sleep innovations, exclusive distribution, and lifelong customer relationships. These strategic choices contributed to a 16% return on invested capital for 2018, compared to our high single-digit weighted average cost of capital.

Our revolutionary Sleep Number 360® smart beds have disrupted the industry. With the only bed that delivers proven quality sleep, Sleep Number is at the intersection of sleep, technology and health trends. Consumer enthusiasm for our smart bed drove double-digit sales growth since we completed the transition of our product line in the back half of 2018. Record full-year results included:

- Net sales increase of 6% to $1.53 billion, and
- Earnings per diluted share increase of 24% to $1.92.

In 2019, we expect to generate earnings per diluted share of between $2.25 and $2.75, up 17% to 43% versus prior year.

Sleep Number 360 smart bed

Five years ago, we saw the potential of connected technology and incorporated biometric tracking into our Sleep Number® beds with SleepIQ® technology. Today, more than half of consumer households are interested in purchasing sleep tracking technology. Our 360® smart beds detect movement, sleep disturbances, and biometric changes, and then use that information to automatically adjust the bed's firmness for each individual sleeper.

We are communicating the vital role that this life-changing sleep plays in overall wellness through our integrated marketing campaigns, storytelling, and social media. We are amplifying our purpose-driven brand through groundbreaking partnerships with the NFL, the NFL Players Association, and the Professional Football Athletic Trainers Society. Now, over 1,800 NFL players are sleeping on our 360 smart beds and experiencing the powerful link between quality sleep and their performance.

sleep number.

Lifelong customer relationships with our brand are another key competitive advantage that drives sustainable, profitable growth. With digital at the core of our smart beds, customers now interact with our brand daily. They can use their SleepIQ® score to understand how quality sleep impacts their day. This deep engagement leads to increased customer loyalty, which drives higher referrals and repeat sales.

Our integrated online and retail strategy highlights the science and value of our smart beds. Our exclusive distribution is also an important competitive advantage. With award-winning store design and interactive technology, our 580 Sleep Number® stores deliver a unique sales experience across all 50 states.

The 360 smart bed is creating leverage across our business. With our full line of smart beds in place, we expect the absence of transition costs to benefit 2019. The simpler bed design and streamlined operational processes drive efficiencies in manufacturing, logistics, and supply chain. The multi-year network evolution is improving assembly flow, reliability, and scale.

Looking Ahead

In many ways, we are just getting started with our 360 smart beds, which have tremendous potential to add increasing value to consumers' well-being. Today, our smart bed's SleepIQ® platform captures over 8.5 billion biometric data points every night and uses that data to deliver proven quality sleep. In the future, SleepIQ technology will likely enable customers to use their smart bed to better manage their health and wellness.

We are excited to be in a position of broader relevance in a changing consumer and competitive landscape. We expect our purpose-driven company, which is delivering life-changing sleep, to continue to generate top-tier shareholder returns over the long term.

Sleep well, dream big,

Shelly Ibach

Shelly Ibach
Sleep Number® setting 40, average SleepIQ® score of 82
President and Chief Executive Officer

1001 Third Avenue South
Minneapolis, Minnesota 55404

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
May 15, 2019

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 15, 2019**. The meeting will be conducted completely as a virtual meeting via the Internet at **www.virtualshareholdermeeting.com/SNBR2019**. The purposes of the meeting are to:

1. Elect four 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 2019 fiscal year ending December 28, 2019.

Shareholders of record at the close of business on March 20, 2019 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 15, 2019 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 15, 2019: The Proxy Statement and Annual Report for the year ended December 29, 2018 and related materials are available at *www.sleepnumber.com/investor-relations*.

These materials were first sent or made available to our shareholders on April 2, 2019.

By Order of the Board of Directors,

Samuel R. Hellfeld
Senior Vice President,
Chief Legal and Risk Officer and Secretary

Minneapolis, Minnesota April 2, 2019

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TABLE OF CONTENTS

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.

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1001 Third Avenue South
Minneapolis, Minnesota 55404

PROXY STATEMENT
FOR
ANNUAL MEETING OF SHAREHOLDERS

May 15, 2019

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 2019 Annual Meeting of Shareholders.

When is the Annual Meeting and how can I attend?

The Annual Meeting will be held at 8:30 a.m. Central Time on May 15, 2019. The meeting will be conducted completely as a virtual meeting via the Internet. Shareholders may attend the meeting and submit questions electronically during the meeting via live webcast by visiting the virtual meeting platform at www.virtualshareholdermeeting.com/SNBR2019. 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. Shareholders may log into the virtual meeting platform beginning at 8:15 a.m. Central Time on May 15, 2019. The meeting will begin promptly at 8:30 a.m. Central Time on May 15, 2019.

Why is this Annual Meeting virtual?

We are utilizing technology to provide expanded access and participation, improved communication, and cost savings to benefit our shareholders and the company. Shareholders will be able to listen, vote, and submit questions from any remote location through the Internet. The virtual format for the Annual Meeting is also environmentally friendly and sustainable over the long-term.

What if I have technical difficulties during the meeting or trouble accessing the virtual Annual Meeting?

We will have technicians ready to assist you with any technical difficulties you may have accessing the virtual meeting. If you encounter any difficulties accessing the virtual meeting during check-in or the meeting, please call the technical support number that will be posted on the virtual meeting platform log-in page.

Who is entitled to vote?

Shareholders of record at the close of business on March 20, 2019 (the "Record Date") are entitled to vote at the meeting. As of the Record Date, there were 30,127,273 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 2, 2019, 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 2, 2019.

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 four 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 28, 2019.

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 28, 2019.

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 15,063,637 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 to be received by no later than May 13, 2019; or
- Over the *Internet* during the 2019 annual meeting by going to www.virtualshareholdermeeting.com/SNBR2019 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 15, 2019 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 13, 2019;

- Submitting to the Corporate Secretary before 6:00 p.m., Eastern Daylight Time, on May 13, 2019, 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 14, 2019; 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.

You may view this year's proxy materials at **www.proxyvote.com.** 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.

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 23, 2019 (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 51 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)(3)	Percent of Class
Common Stock	Daniel I. Alegre	24,965	*
Common Stock	Andrea L. Bloomquist	121,580	*
Common Stock	Kevin K. Brown	47,482	*
Common Stock	David R. Callen	75,792	*
Common Stock	Andrew P. Carlin	75,303	*
Common Stock	Stephen L. Gulis, Jr. (4)	89,118	*
Common Stock	Michael J. Harrison (4)	47,435	*
Common Stock	Shelly R. Ibach	449,880	1.5%
Common Stock	Deborah L. Kilpatrick, Ph.D.	1,376	*
Common Stock	Brenda J. Lauderback (4)	47,490	*
Common Stock	Barbara R. Matas (4)	16,766	*
Common Stock	Kathleen L. Nedorostek (4)	43,965	*
Common Stock	Vicki A. O'Meara	9,845	*
Common Stock	Michael A. Peel (4)	112,898	*
Common Stock	Jean-Michel Valette	281,486	*
Common Stock	All directors and executive officers as a group (20 persons) (5)	1,749,142	5.6%
Common Stock	BlackRock, Inc. (6) 55 East 52nd Street New York, New York 10055	4,772,079	15.7%
Common Stock	Disciplined Growth Investors, Inc. (7) 150 South Fifth Street, Suite 2550 Minneapolis, Minnesota 55402	3,603,954	11.9%
Common Stock	The Vanguard Group, Inc. (8) 100 Vanguard Blvd. Malvern, Pennsylvania 19355	3,394,508	11.2%

Common Stock	Vulcan Value Partners, LLC [9] 2801 Highway 280 South, Suite 300 Birmingham, Alabama 35223	2,716,036	9.0%
Common Stock	Dimensional Fund Advisors LP [10] 6300 Bee Cave Road, Building One Austin, Texas 78746	1,755,694	5.8%

* 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 (11,357 shares); Ms. Bloomquist (57,425 shares); Mr. Brown (26,750 shares); Mr. Callen (33,538 shares); Mr. Carlin (19,300 shares); Mr. Gulis (22,232 shares); Mr. Harrison (14,826 shares); Ms. Ibach (261,834 shares); Ms. Lauderback (17,232 shares); Ms. Matas (4,122 shares); Ms. Nedorostek (17,232 shares); Ms. O'Meara (4,122 shares); Mr. Peel (21,732 shares); and Mr. Valette (22,232 shares).

(3) The shares shown include the following shares that executive officers have the right to acquire within 60 days through the vesting of restricted stock units: Mr. Carlin (18,880 shares); and through the vesting of performance restricted stock units: Ms. Bloomquist (14,449); Mr. Brown (10,837); Mr. Callen (14,449); Mr. Carlin (14,449); and Ms. Ibach (75,862).

(4) 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 the earlier of an elected date or separation of service from the company. Mr. Gulis's amount includes 49,746 shares that were deferred in lieu of Director fees and 17,140 RSUs that were deferred. Mr. Harrison's amount includes 2,345 shares that were deferred in lieu of Director fees and 6,719 RSUs that were deferred. Ms. Lauderback's amount includes 9,255 RSUs that were deferred. Ms. Matas' amount includes 6,921 shares that were deferred in lieu of Director fees and 3,852 RSUs that were deferred. Ms. Nedorostek's amount includes 14,593 shares that were deferred in lieu of Director fees. Mr. Peel's amount includes 10,929 RSUs that were deferred.

(5) Includes an aggregate of 640,305 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 184,776 shares held under performance restricted stock units that have not vested and 19,090 shares that Directors and executive officers as a group have the right to acquire within 60 days through the vesting of restricted stock units. Also includes 73,606 shares that were deferred by non-employee Directors in lieu of Director fees and 121,470 RSUs that were deferred by executive officers and non-employee Directors.

(6) BlackRock, Inc. reported in a Schedule 13G filed with the Securities and Exchange Commission on January 31, 2019 that as of December 31, 2018 it beneficially owned 4,772,079 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 4,689,434 shares and sole dispositive power with respect to 4,772,079 shares.

(7) Disciplined Growth Investors, Inc. reported in a Schedule 13F filed with the Securities and Exchange Commission on February 13, 2019 that as of December 31, 2018 it beneficially owned 3,603,954 shares of Common Stock of Sleep Number Corporation, had sole dispositive power with respect to 3,603,954 shares, sole power to vote or to direct the vote with respect to 2,994,791 shares and no voting power with respect to 609,163 shares.

(8) The Vanguard Group, Inc. reported in a Schedule 13G/A filed with the Securities and Exchange Commission on February 11, 2019 that as of December 31, 2018 it beneficially owned 3,394,508 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 68,190 shares, shared power to vote or to direct the vote with respect to 6,230 shares, shared dispositive power with respect to 70,650 shares and sole dispositive power with respect to 3,323,858 shares.

(9) Vulcan Value Partners, LLC reported in a Schedule 13G/A filed with the Securities and Exchange Commission on February 14, 2019 that as of December 31, 2018 it beneficially owned 2,716,036 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 2,675,030 shares and sole dispositive power with respect to 2,716,036 shares.

(10) Dimensional Fund Advisors LP reported in a Schedule 13G filed with the Securities and Exchange Commission on February 8, 2019 that as of December 31, 2018 it beneficially owned 1,755,694 shares of Common Stock of Sleep Number Corporation, had sole power to vote or to direct the vote with respect to 1,627,375 shares and sole dispositive power with respect to 1,755,694 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 2019 Annual Meeting, our Board will consist of 11 members, four of which will be up for election at the 2019 Annual Meeting. The Board has nominated **Michael J. Harrison, Shelly R. Ibach, Deborah L. Kilpatrick, Ph.D., and Barbara R. Matas** for election to the Board, each for a term of three years expiring at the 2022 Annual Meeting, or until their successors are elected and qualified. Mr. Harrison, Ms. Ibach, Ms. Kilpatrick and Ms. Matas have each consented to being named as a nominee in this Proxy Statement and to serve as a Director if elected. Mr. Harrison has served on our Board since 2011; Ms. Ibach has served on our Board since 2012; Ms. Kilpatrick has served on our Board since 2018; and Ms. Matas has served on our Board since 2016. As previously announced, in light of her increasing professional commitments, Vicki O'Meara will be retiring from the Board following the Annual Meeting. The Company thanks Ms. O'Meara for her service and dedication during her tenure as a member of the Board.

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. Harrison, Ms. Ibach, Ms. Kilpatrick and Ms. Matas. 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 2022:		
Michael J. Harrison Age 58	**Occupation:** Board Director since January 2016, and previously interim CEO from March 2014 to May 2015, of OOFOS, Inc., the pioneer in the emerging global category of recovery footwear for athletes; President & Chief Operating 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.	2011
	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, Inc. Prior: Totes/Isotoner Corporation	

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
Shelly R. Ibach Age 59	**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.	2012
	Qualifications: Ms. Ibach brings leadership, experience and perspective as Sleep Number's President and CEO along with a dedication to sustainable, long-term growth and shareholder value. Ms. Ibach brings an intimate knowledge of our customer, culture, strategy, product, marketing, operations and competitive environment gained during 12 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.	
Deborah L. Kilpatrick, Ph.D. Age 51	**Occupation:** Chief Executive Officer of Evidation Health, Inc., a digital health company, since 2014; Vice President of Market Development and Chief Commercial Officer of CardioDx, a genomic diagnostics company from 2006 to 2014 with responsibility for sales, marketing, and reimbursement from insurers; Held multiple leadership roles at Guidant Corporation, a medical device company, from 1998 to 2006 (acquired by Boston Scientific), including Research Fellow, Director of R&D, and Director of New Ventures in the Vascular Intervention Division; Serves on the College of Engineering Advisory Boards for Georgia Tech and the California Polytechnic State University, and is a Fellow of the American Institute of Medical and Biological Engineering; Holds multiple patents in medical device technologies and drug delivery devices; Advises multiple venture capital funds and privately-held startup companies in the digital health and health care sectors.	2018

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
	Qualifications: Ms. Kilpatrick brings to our Board substantial expertise and experience in the development and commercialization of digital health products, and a track record of successful product innovation to transform health care with big data in the genomic and digital era. With her deep understanding of digital health opportunities and passion for our sleep innovations, Ms. Kilpatrick's appointment to our Board supports our strategy of improving lives through individualizing sleep experiences and advancement of our SleepIQ technology platform.	
	Other Company Boards (privately held): Current: Evidation Health, Inc.; NextGen Jane, Inc.	
Barbara R. Matas Age 59	**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 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.	2016
	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	
THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS YOU VOTE "FOR" THE ELECTION OF EACH OF THE NOMINEES LISTED ABOVE		

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
Directors not standing for election this year whose terms expire in 2020:		
Kathleen L. Nedorostek Age 66	**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.	2011
	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.	
Vicki A. O'Meara Age 61	**Occupation:** Executive Chairman and Board Chair, AdSwerve, Inc., a marketing technology company, since 2018; Former Chief Executive Officer, Analytics Pros, Inc., a digital analytics consultancy, from 2014 to 2018; 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.	

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
	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 69	**Occupation:** Currently serves as Senior Advisor to the leadership advisory firm ghSMART and is Managing Partner of Peel Global Advisory, LLC; Previously served as a Senior Officer of Yale University from October 2008 until his retirement in July 2017, including most recently as Chief Human Resources and Administration Officer; Prior to joining Yale, Mr. Peel spent 17 years as a member of the top management team at General Mills, Inc., a manufacturer and marketer of consumer food products, including serving as Executive Vice President of Human Resources & Global Business Services; Also, Mr. Peel had 14 years of experience at PepsiCo, Inc., including serving as Chief Human Resources Officer for two of its largest operating divisions, PepsiCo Worldwide Foods and Pepsi-Cola Bottling Group.	2003
	Qualifications: Mr. Peel is a widely recognized Human Resources 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.	

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
Jean-Michel Valette Age 58	**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 Consumer Equity Research and Branded Consumer Venture Capital Investments at Hambrecht & Quist LLC, an investment banking firm, during the 1980s and 1990s.	1994
	Qualifications: Mr. Valette provides our Board with significant, relevant leadership and a proven track record of significant long-term 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	
Directors not standing for election this year whose terms expire in 2021:		
Daniel I. Alegre Age 50	**Occupation:** President of Google Retail, Shopping and Payments since August, 2017; Held various roles at Google, Inc. since 2004, including President of Global Partnerships, as well as 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.	2013

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
	Qualifications: Mr. Alegre provides our 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.	
Stephen L. Gulis, Jr. Age 61	**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.	2005
	Qualifications: Mr. Gulis provides our 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, 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 68	**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.	2004

Name and Age of Nominee and/or Director	Principal Occupation, Business Experience and Directorships of Other Companies	Director Since
	Qualifications: Ms. Lauderback provides 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	

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 2018 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
Deborah L. Kilpatrick, Ph.D.	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.	X		X
Michael J. Harrison		X	X
Deborah L. Kilpatrick, Ph.D.	X		
Brenda J. Lauderback		Chair	
Barbara R. Matas	Chair		
Kathleen L. Nedorostek		X	X
Vicki A. O'Meara	X		
Michael A. Peel			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 2018. The Audit Committee met in person or by telephone conference eight times during 2018. The Management Development and Compensation Committee met in person or by telephone conference five times during 2018. The Corporate Governance and Nominating Committee met in person or by telephone conference seven times during 2018. Each of the members of our Board of Directors serving in 2018 attended 75% or more of all meetings of the Board and committees on which they served during fiscal 2018.

Audit Committee. The Audit Committee is comprised entirely of independent Directors, currently including Barbara R. Matas (Chair), Stephen L. Gulis, Jr., Deborah L. Kilpatrick, Ph.D. 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 65 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 and Kathleen L. Nedorostek. 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 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 30 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 10 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, 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 Director candidates in the context of the Board's overall composition, 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, six of our 11 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 Engagement

Our Board of Directors and management team maintain a deep commitment to strong corporate governance. Engagement with, and accountability to, our shareholders are cornerstones of this commitment. Accordingly, we maintain an active shareholder engagement program that facilitates channels of communication and aims to foster relationships with our shareholders to drive sustainable, long-term growth and shareholder value. As part of our engagement program, members of our management team and the Chairman of the Board of Directors regularly meet with shareholders, in-person or by phone, to discuss strategy, governance, pay for performance orientation, and other matters of shareholder interest. Our ongoing shareholder engagement and commitment to long-term value creation will continue to inform the Board of Director's deliberations in 2019 and beyond.

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 or make exceptions to 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 2018 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:

Independence. 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 our Chief Executive Officer, 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 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 shall 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 Director candidates in the context of the Board's overall composition, 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 executive officers, the performance of the Chief Executive Officer against such criteria, and the compensation of the Chief Executive Officer and other executive officers. Additional executive sessions or meetings of independent 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. Executive sessions or meetings with the CEO shall be held from time-to-time for a general discussion of relevant topics.

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 for executive officers and Directors as further described in the Compensation Discussion and Analysis beginning on page 30 of this Proxy Statement and as summarized below.

- *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 independent 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 executive officers whom report directly 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.

Social Impact

Our mission is to improve lives by individualizing sleep experiences. Every day, we educate consumers on the importance of sleep and its connection to their overall wellness. We inspire them to make it a priority in their lives. In 2018, we announced our commitment to help over one million young people achieve life-changing sleep through our products and sleep expertise. We are partnering with leading national organizations focused on youth health and wellness initiatives to achieve their commitment, including GENYOUth, Alliance for a Healthier Generation and Good360. We believe excellent sleep is essential to a healthier and happier society, strengthening our connections with one another, and expanding the frontier of what's possible. We strive to conduct our business in an ethical and socially responsible manner. In addition to our Code of Business of Conduct detailed below, we maintain a Code of Conduct for Business Partners that addresses labor and human rights, health and safety, environmental issues, ethics, and compliance with related laws, rules and regulations. We also maintain Equal Employment Opportunity standards to foster a culture of diversity, inclusion and respect.

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 regularly monitor compliance with the Code of Business Conduct and report to our Audit Committee with respect to our findings. 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 29, 2018 and there are none currently contemplated.

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 J. Harrison
Kathleen L. Nedorostek

COMPENSATION DISCUSSION AND ANALYSIS

Table of Contents:

Introduction

The Compensation Discussion and Analysis (CD&A) describes our executive compensation program, including the objectives and elements of compensation as well as determinations made by the Committee regarding our named executive officers (NEOs).

For 2018, the following five current executive officers were determined to be NEOs as a result of their position during the year as chief executive officer (CEO), or chief financial officer (CFO), or their total compensation making them among the three other highest paid executives for the fiscal year.

Name	Position Title
Shelly R. Ibach	President and Chief Executive Officer (CEO)
David R. Callen	Senior Vice President and Chief Financial Officer (CFO)
Andrew P. Carlin	Executive Vice President and Chief Sales and Services Officer
Andrea L. Bloomquist	Senior Vice President and Chief Product Officer
Kevin K. Brown	Senior Vice President and Chief Marketing Officer

Compensation Philosophy and Approach

The executive compensation program is designed to support our long-term strategic orientation. It is competitive, heavily weighted toward performance-based incentive programs, and encourages appropriate risk taking and investing in the business as we execute our consumer innovation strategy. Our incentive programs reward our executive officers for superior performance and strengthening competitive advantages to deliver sustainable, long-term profitable growth. The incentive opportunities are tied to multiple financial metrics that support our business strategy and are aligned with shareholder interests.

Our executive compensation program is designed to:

- Motivate and retain a talented management team to achieve superior company performance that is sustainable over time
- Provide a market competitive total compensation opportunity that is predominantly performance based and at risk
- Reward executives for achieving financial performance goals and creating shareholder value
- Reinforce our pay for performance culture that requires above-median performance for above-median compensation

Shareholders have expressed their support of our executive compensation program and its alignment with company performance. Over the last six years (2013-2018), an average of 96% of votes cast by shareholders were in support of our annual proposal to approve, on an advisory basis, the compensation of the company's NEOs including 93% of votes cast at our 2018 Annual Meeting. We have maintained this strong support from our shareholders over time. We have regular outreach discussions with shareholders to benefit from their interests. We regularly review and update our executive compensation program to ensure alignment with our objectives. We also adhere to many governance best practices and policies.

Progress as a Company

The U.S. retail bedding market is approximately $16 billion, fragmented, and competitive. Sleep Number is breaking through the commodity-driven "sea of sameness" by executing our consumer innovation strategy and delivering highly differentiated innovations. Consumers are engaged with our purpose-driven brand and are responding strongly to our new revolutionary 360 smart beds. The execution of our strategy has broadened our relevance, as individuals increasingly understand the importance of quality sleep to their overall well-being. As the sleep innovation leader, we are taking market share and realizing the benefits of our advantaged products and integrated marketing and retail initiatives.

In 2012, we embarked on a transformational, consumer innovation strategy as the path to improve lives and deliver sustainable, profitable long-term growth. Executing this strategy has required significant capital investments, substantial buildout of vital performance capabilities, and time to execute these plans. Since 2012, we have taken numerous transformative actions including:

- Prioritized innovation by increasing nearly three-fold our R&D spend as a percent of net sales
- Invested approximately a half billion dollars of capital, including two strategic acquisitions with critical intellectual property setting the stage for innovation leadership
- Strengthened our direct-to-consumer (DTC) model with exclusive distribution and optimized real estate operating in all 50 states
- Elevated our customers' in-store experience with award-winning design and technology enhancements and approximately 50% larger average store size in more favorable locations, shifting the majority of our stores to non-mall locations
- Simplified and enhanced online experience resulting in an integrated, omni-channel retail experience
- Developed superior marketing capabilities to compete and win in an industry of nearly 200 brands (versus approximately 10 in 2012) and embraced important partnerships such as the National Football League (NFL) to raise our brand profile and expand our consumer reach
- Built and launched two vital technology platforms with our vertically integrated ERP system and the game-changing SleepIQ technology that automatically adjusts comfort for improved sleep quality
- Transitioned more than 20 suppliers to support our innovative new products and to advance our margin enhancing initiatives.

In summary, we operate with a compensation program designed to reward achievement of superior results and creation of long-term shareholder value.

2018 Performance and Accomplishments

We delivered superior performance in 2018 with net sales and earnings per share (EPS) exceeding street consensus and the midpoint of our external guidance. With additional transition costs and investments, we fell short of our aggressive internal business plan on adjusted EBITDA and net operating profit (NOP) for the year. Consumers have responded strongly to our innovations, driving accelerated sales growth in the back-half of the year. Highlights of our full year financial results include:

- Record net sales of more than $1.5 billion, up 6%, with positive comp sales for the fifth consecutive year
- EPS growth of 24% to $1.92
- Net operating profit after taxes (NOP) of $92.4 million (+1%) and adjusted EBITDA of $165.6 million (-2%), while absorbing approximately $16 million of product transition impacts
- Operating cash flow of $132 million with $46 million in capital expenditures and $279 million in share repurchases
- Return on invested capital (ROIC) of 16%, up 170 basis points and an 80% premium to our cost of capital we employ

Performance metrics in our compensation program:

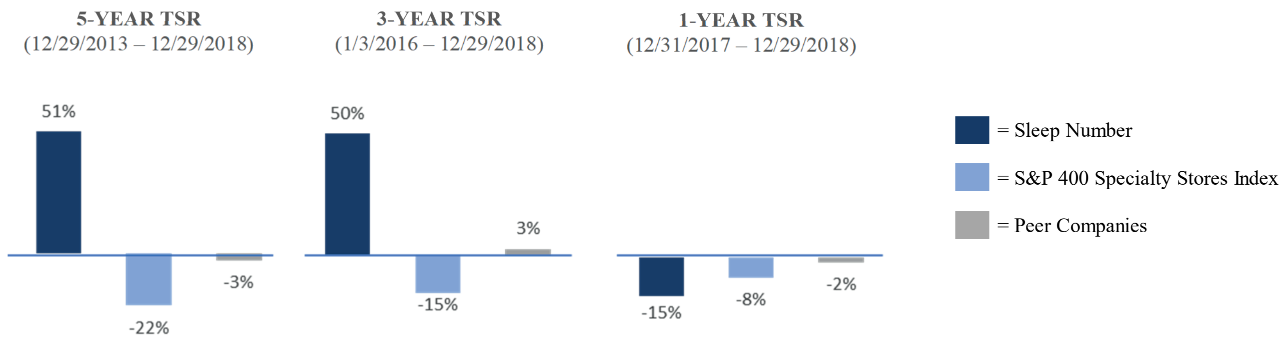
Annual incentive plan:
✓ Adjusted EBITDA

Long-term incentive plan:
✓ Net sales growth
✓ NOP growth
✓ ROIC

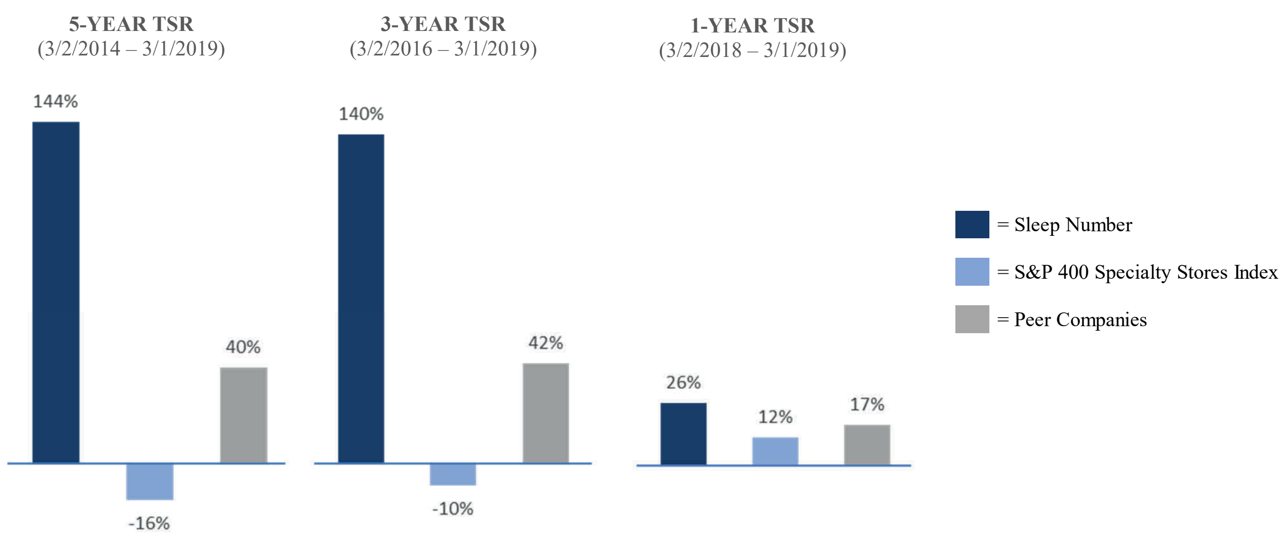
For additional information on our non-GAAP financial measures, such as adjusted EBTIDA and ROIC, see "Non-GAAP Data Reconciliations" in our Annual Report on Form 10-K filed on February 26, 2019.

In addition to these financial results, consumers again recognized Sleep Number with a J.D. Power Award for #1 in Customer Satisfaction with Mattresses and #1 in the top six categories of support, durability, comfort, variety of features, value and warranty. We took market share in 2018 as consumers choose the sleep benefits of our 360® smart beds, reaching more than 410 million sleep sessions for the year. While completing our transition to 360 smart beds, we continued to evolve our outbound logistics network and execute continuous improvement initiatives across the business.

We delivered a total shareholder return (TSR) for three and five years that was in the top quartile of our peer companies (as described on page 49) when measured through the end of our fiscal year 2018. Our one, three, and five-year TSR are in the top quartile when the measurement period ends on March 1, 2019 to include the market reaction to our fourth quarter earnings release issued on February 13, 2019.



TSR results when the measurement period ends on March 1, 2019:



Notes: TSR refers to the percent change in the value of a shareholder's investment in the company over the measurement period as determined by change in share price plus the value of any dividends paid. Peer companies are described on page 49.

We are delivering life-changing value to our customers, resulting in superior shareholder value creation.

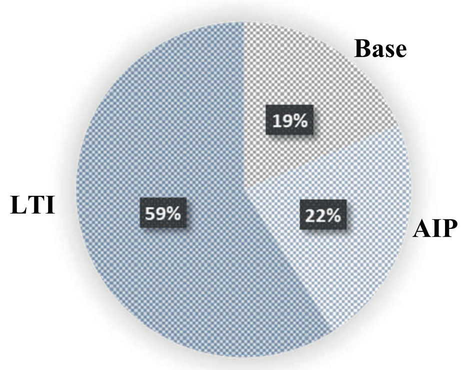
Compensation Program Overview

Our pay for performance compensation program has three main components that make up the total direct compensation opportunity for our executive officers, as summarized in the table below. With the effectiveness of the program, there were no changes to the design of these elements of our compensation program for 2018.

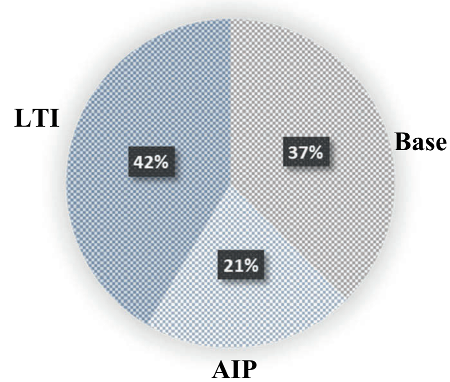
Element	Form	Metrics	Performance Period	Description
Base Salary	Cash	n/a	n/a	Fixed pay component, reviewed annually and eligible for merit considering individual performance and positioning vs. external benchmarks
Annual Incentive Plan (AIP)	Cash	Adjusted EBITDA (100% weighting)	One year	Target annual incentive opportunity represents a percent of base salary. Actual **payout can range from 0 to 250% of target** based on adjusted EBITDA performance for the year
Long-Term Incentive Plan (LTI)	Performance Restricted Stock Units (Performance RSUs) (75% of LTI Grant Value)	Net Sales Growth (50% Weighting) NOP Growth (50% Weighting) ROIC Modifier Share Price Growth	Three-year vesting and performance period	Annual equity grant opportunity. **Payout can range from 0 to 200% of target** RSUs granted based on net sales and NOP annual growth over the three-year performance period, subject to a potential ROIC performance modifier. Value is tied to share price
	Non-Qualified Stock Options (NQSOs) (25% of LTI Grant Value)	Share Price Growth	Three-year vesting period and ten-year term	Annual equity grant opportunity. **Options only have value if future share price is higher than share price at time of grant**

By design, our executive compensation mix is heavily weighted toward performance-based incentive programs that only have value if company performance meets or exceeds pre-determined financial goals, or if shareholder value increases. As highlighted in the charts below, over 80% of our CEO's target total direct compensation opportunity is performance-based and fully at-risk; for our other NEOs, this percentage is over 60%.

CEO



Other NEOs



Our AIP and LTI are performance-based incentive programs that are tied to company performance metrics aligned with shareholder interests

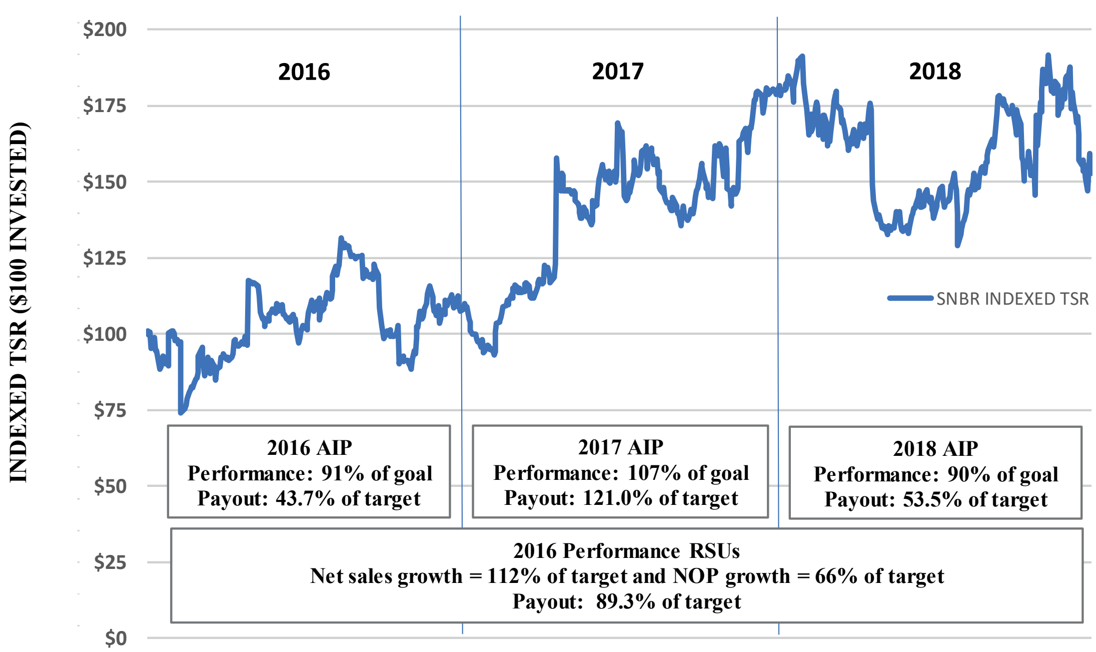
AIP: *adjusted EBITDA*
LTI: *net sales, NOP, ROIC and share price*

Pay and Performance Alignment

The letter to shareholders from our CEO in this Proxy Statement and the section "2018 Performance and Accomplishments" provide a full description of our performance for the year. The following is a summary of our company performance that determined the actual payouts earned for our 2018 AIP and 2016 Performance RSUs. The performance and payouts for these incentive programs are described in more detail later in this CD&A.

Element	Performance Achieved	Payout
2018 AIP	– Adjusted EBITDA for 2018 was $165.6 million (-2.1% vs. 2017) – This was 90% of the AIP goal for target payout	**53.5% of target payout** (Compared to a payout of 121% of target for 2017)
2016 Performance RSUs (performance period of fiscal years 2016 to 2018)	– Annual revenue growth was above threshold in all three years at 8.0%, 10.2%, and 6.0% – Annual NOP growth was above target for 2017 at 19.9%. Our below-threshold growth for 2016 and 2018 was primarily due to significant investments in our business that were essential to our long-term strategy – Average ROIC premium vs. weighted average cost of capital (WACC) was 73%, well in excess of threshold – Total shareholder return (TSR) was 50% for the performance period	**89.3% of target payout** **(112% of target on net sales and 66% of target on NOP)** (Compared to a payout of 86.2% of target for 2015 Performance RSUs) ROIC negative modifier threshold was exceeded **Share price increased from $21.41 to $32.13** during the three-year performance period

Pay earned for 2018 demonstrates that when the company falls short of its internal goals, payouts are reduced below target. The following chart illustrates the alignment between our incentive payouts and shareholder outcomes for the three-year period from 2016 to 2018.



Compensation Framework and Actions

Each March, the Committee considers both shareholder feedback and market data provided by its independent consultant when setting the base pay and target incentive opportunities for our executive officers. The Committee generally seeks to align the target direct compensation opportunity with the median of the market (our approach to benchmarking is described in more detail on page 49).

Given the significant weight the executive compensation program places on at-risk and performance-based incentive opportunities, **the compensation realized by our executive officers will vary significantly depending on company performance against pre-determined goals and changes in shareholder value**—an important design objective of our executive compensation program.

Base Salary

We set base salaries for our executive officers to be competitive and to allow us to attract and retain top executive talent. Base salaries are the smallest component of our target 2018 pay mix, comprising 19% of the CEO's target total direct compensation and 37% on average for our other NEOs.

Our Committee reviews base salaries annually, considering market data and both individual and company performance when making base pay decisions. At its meeting on March 8, 2018, the Committee approved the base salary adjustments for 2018 shown in the following table. Ms. Ibach and Mr. Callen each received a combination of a merit increase based on performance and a market adjustment since their respective salaries were both at least 10% below the market median based on benchmarking data provided by the Committee's independent compensation consultant. Other NEOs each received merit increases that considered market position and their performance.

Name	Base Salary at March 26, 2017 (Annualized)	Base Salary at March 25, 2018 (Annualized)
Shelly R. Ibach	$850,000	$950,000
David R. Callen	$435,882	$483,828
Andrew P. Carlin	$459,648	$482,630
Andrea L. Bloomquist	$419,796	$432,390
Kevin K. Brown	$410,568	$426,991

Note: The base salary adjustments approved by the Committee in March 2018 were effective with the pay period beginning March 25, 2018.

Annual Incentive Plan (AIP)

Performance Metric. Our AIP provides our executive officers with an annual incentive opportunity contingent upon our adjusted EBITDA performance. Adjusted EBITDA is a useful indicator of our annual financial performance and our ability to generate cash flow from operating activities, an important source of our shareholder value creation. We define adjusted EBITDA as net income plus: income tax expense, interest expense, depreciation and amortization, stock-based compensation expense and asset impairments (as detailed in our quarterly and annual financial filings). For additional information on adjusted EBTIDA, see “Non-GAAP Data Reconciliations” in our Annual Report on Form 10-K filed on February 26, 2019.

Design Overview. The design of our AIP has two main components that determine the amount of the payout earned by our NEOs for company performance. First is the executive officer’s target incentive opportunity, which is set each year by the Committee considering market data and their position within the company. The other component is the leverage curve with performance goals for adjusted EBITDA that determine the percent of the target payout earned for the year. It is the combination of these two components that results in the final AIP payout for our NEOs.

AIP Target Incentive Opportunity × **% of Target Payout (earned for adjusted EBITDA performance vs. goals)** = **AIP Payout for 2018**

Our AIP includes an opportunity to receive a progress payment if a first half performance goal for adjusted EBITDA is achieved or exceeded. The progress payment is equal to half of the AIP target incentive for the first half of the year. If the progress payment is earned and paid out in July of the fiscal year, it is subtracted from the annual payout earned and paid out following the end of the fiscal year in February. By having this opportunity for a progress payment in our AIP, it reinforces the importance of starting out the year with strong first half performance.

Individual Target Incentive. Each executive officer has a target incentive that is expressed as a percent of the actual salary they receive for the fiscal year. The Committee reviews these targets annually to ensure that they are aligned with the median target incentives and total cash opportunities of our peers and the market (our peer group and approach to benchmarking is described on page 49). The Committee approved the following target annual incentives for the named executive officers for 2018. The Committee increased the target incentive for Ms. Ibach from 115% to 120% of salary effective March 25, 2018 to more closely align with the market median based on benchmarking data provided by the Committee’s independent compensation consultant.

Name	AIP Target Incentive for 2018 (% of salary received)
Shelly R. Ibach	115%/120% *
David R. Callen	55%
Andrew P. Carlin	60%
Andrea L. Bloomquist	55%
Kevin K. Brown	55%

* For Ms. Ibach, her target AIP for 2018 is prorated between the target incentive at the start of the year of 115% and the new target incentive of 120% (effective March 25, 2018).

2018 Performance Goals. At its meeting on January 18, 2018, the Committee approved the following performance goals and range of payout opportunity for the 2018 AIP. These goals and payout opportunities were set to provide a strong motivation for achievement of stretch performance objectives and a reasonable sharing rate of incremental adjusted EBITDA. The 2018 goal for target payout was set at adjusted EBITDA of $183.4 million, an 8% increase over 2017 actual of $169.1 million. When this goal was set, it represented top quartile performance compared to the three-year historical growth rate in EBITDA of our peer companies. The payout levels and performance goals for threshold and maximum were set for 2018 consistent with the AIP methodology for 2017. This approach ensures that there is an appropriate sharing rate for how the AIP payout cost changes with incremental adjusted EBITDA.

	AIP Payout (% of Target)	Annual Adjusted EBITDA Goals (in millions)	% Change vs. 2017 Actual
Threshold	20%	$154.4	-9%
Target	100%	$183.4	+8%
Maximum	250%	$235.5	+39%

For the progress payment opportunity, the Committee approved a first half goal for 2018 of $81.8 million in adjusted EBITDA. The first half goal for 2018 represented our first half operating plan aligned with the annual AIP goal of $183.4 million.

2018 Performance. Although 2018 net sales were up 6% and we achieved our fifth straight year of positive comp sales, we fell short of our internal adjusted EBITDA goal for 2018. Adjusted EBITDA was $165.6 million for 2018, which was 90% of the AIP goal for target payout. This represented a 2.1% decline over the prior year driven in part by approximately $16 million of profit impacts to complete the replacement of our mattress and adjustable base product lines with the 360 smart bed in 2018. For this level of 2018 adjusted EBITDA, we earned an AIP payout of 53.5% of target. The Committee approved this payout, as it is reflective of our pay for performance alignment, while acknowledging the significant business improvements accomplished to drive accelerated sales and profit growth in the back half of 2018.

	AIP Payout (% of Target)	Adjusted EBITDA	% Change vs. 2017 Actual
Actual	53.5%	$165.6 M	-2.1%

Our first half adjusted EBITDA was $66.8 million, below our goal of $81.8 million in order to earn a progress payment for the 2018 AIP. As a result, no progress payment was made in July 2018.

2018 Payout. The following table shows the actual AIP payout earned for 2018 based on the target incentive opportunity for each NEO and approved payout of 53.5% of target. There was no progress payment made for first half of 2018, so the full AIP payout amounts shown below were paid out in February 2019.

Name	2018 AIP Payout	% Change in AIP Payout (2018 vs. 2017)
Shelly R. Ibach	$589,837	-48%
David R. Callen	$139,111	-51%
Andrew P. Carlin	$153,222	-53%
Andrea L. Bloomquist	$126,376	-54%
Kevin K. Brown	$124,527	-54%

Long-Term Incentive Plan (LTI)

Design Overview. LTI is the largest component of the total direct compensation opportunity for our executive officers and one of the most critical. It provides a reward opportunity that is directly aligned with the long-term interest of our shareholders. As an incentive, there is only payout value if we achieve certain long-term company performance goals or, for stock options, positive stock price appreciation. The grants have multi-year vesting requirements which also assist in the retention of our executive team; considered especially important to executing a long-term oriented innovation strategy.

The design of our LTI includes two types of annual equity grants: Performance RSUs and Stock Options. For 2018, our executive officers received an annual total LTI grant value that was split 75% in Performance RSUs and 25% in Stock Options (same mix as the 2017 LTI grants). This combination appropriately rewards our executive officers for achieving long-term profitable growth and the creation of shareholder value.

Total LTI Grant Value

× 75% = **Performance RSUs** (Target Grant Value)

× 25% = **Stock Options** (Grant Value)

These LTI grants only have payout value if company performance goals are achieved for RSUs or shareholder value is created for stock options

As a condition of accepting any LTI grant, our executive officers agree to reasonable restrictions on their activities during and for a reasonable period of time after their respective termination of employment, including, but not limited to, the assignment of inventions, non-competition, non-solicitation, confidentiality, and an agreement to arbitrate disputes.

2018 Stock Option Grants. Stock options vest in three equal annual installments on each of the anniversaries following the grant date. Their term expires 10 years after the grant date, provided they have not been exercised or cancelled earlier due to certain events, and their exercise price is equal to the closing trading price of the company's common stock on the grant date.

The number of stock options granted in 2018 was determined by dividing the target option grant value (25% of the executive officer's total LTI grant value) by the calculated grant date fair value per stock option. In this calculation of the grant date option value, we derive a Black-Scholes value under generally accepted accounting principles, using a 20-day average stock price leading up to grant date in order to mitigate short-term stock price volatility. See the footnotes to the "Summary Compensation Table" and "Grants of Plan-Based Awards" for a description of how grant date fair value is determined for purposes of the disclosure in these tables.

The grant date for stock options granted in 2018 was March 21, 2018, the 20-day average share price was $35.80, estimated Black-Scholes value per option was 41% of share price, and the option exercise price was $34.35.

2018 Performance RSU Grants. Performance RSUs become vested on the third anniversary of the grant date, and a percent of target is earned and paid out based on company performance against annual growth goals over a three-year performance period. The payout under the Performance RSUs may be reduced based on an ROIC modifier. The performance metrics for 2018 Performance RSUs are annual growth in net sales and NOP over fiscal years 2018, 2019 and 2020. Prior to the grant date, the Committee established annual growth goals for each of the three years, based on top-quartile peer performance which will determine the percent of target payout earned for net sales and NOP for the entire performance period. The annual measurement for either metric can range from 50% to 200% of target, with the threshold payout being 50% of target if the threshold performance goal is achieved.

At the end of the three-year performance period, the payout for Performance RSUs is determined based on the average of the payouts earned for each of the three years in the performance period, with net sales and NOP equally weighted each year. By assessing growth achieved each year relative to long-term growth goals, our executive officers are able to make the appropriate investments in the business during ever-changing market and competitive environments while prioritizing long-term profitable and sustainable growth.

The final payout of Performance RSUs is subject to a ROIC modifier that can reduce the payout by up to 20%. The reduction occurs if the three-year average difference between ROIC and weighted average cost of capital (WACC) for the 2018-2020 period is below a certain threshold established by the Committee prior to the grant date. The ROIC modifier was added to the design of the Performance RSUs in 2015 to reduce the payout if capital investments in the business do not generate returns that are sufficiently above the WACC.

The following chart illustrates how the overall payout for 2018 Performance RSUs, covering the 2018-2020 period, will be determined.

Net Sales			NOP		
2018	Net sales annual growth each year	*% of target payout earned for net sales each year*	**2018**	NOP annual growth each year	*% of target payout earned for NOP each year*
2019			**2019**		
2020			**2020**		
	Three-year average	*% of target earned for net sales*		Three -year average	*% of target earned for NOP*

Overall payout: Average of the **% of target earned for net sales and NOP** (equal weighting) times the target number of Performance RSUs granted; then subject to a potential reduction of up to 20% if the difference between ROIC and WACC is below a certain threshold

The target number of Performance RSUs for the 2018 award was determined by dividing the grant value (equal to 75% of the executive officer's total LTI grant value) by the estimated grant date fair value per share, which is calculated using 20-day average stock price leading up to grant date in order to mitigate short-term stock price volatility. See the footnotes to the "Summary Compensation Table" and "Grants of Plan-Based Awards" for a description of how grant date fair value is determined for purposes of the disclosure in these tables.

The grant date for Performance RSUs granted in 2018 was March 21, 2018 and the 20-day average share price was $35.80.

2018 LTI Grant Values. The Committee approves a total LTI grant value for each executive officer, considering the executive officer's performance and level of responsibility, as well as the competitive position of the officer's targeted total direct compensation. The Committee seeks to make LTI grants to provide a total direct compensation opportunity that is near the market median.

The following table summarizes the LTI grants made to our NEOs in 2018, and the split in grant value between Performance RSUs (75%) and Stock Options (25%). The LTI grant values for Ms. Ibach and Messrs. Callen and Brown were increased for 2018 to have their target total direct compensation opportunity be more aligned with the market median based on benchmarking data provided by the Committee's independent compensation consultant.

Name	Actual LTI Grants for 2018 (Granted March 21, 2018) *		
	Performance RSU Grant Value at Target	**Stock Option Grant Value**	**Total LTI Grant Value**
Shelly R. Ibach	$2,250,000	$750,000	$3,000,000
David R. Callen	$393,750	$131,250	$525,000
Andrew P. Carlin	$450,000	$150,000	$600,000
Andrea L. Bloomquist	$337,500	$122,500	$450,000
Kevin K. Brown	$337,500	$122,500	$450,000

Performance RSU grants only have payout value if company performance goals are achieved.

Stock options only have value if shareholder value is created.

* The actual grant date fair value for these LTI grants as disclosed in the Summary Compensation Table will vary slightly from the amounts shown above due to valuation assumptions as described in the footnotes to the "Grants of Plan-Based Awards" table on page 53.

2016 Performance RSU Payout. The 2016 Performance RSUs covering the 2016-2018 period, which are similar in design as the 2018 Performance RSUs, were granted on March 22, 2016 and vested and paid out on March 22, 2019 in the form of shares of common stock, less tax withholding settled in shares of common stock. Based on net sales and NOP annual growth over the three fiscal years (2016, 2017, and 2018), the overall payout earned for this grant was 89.3% of target. As described below, this was an average of the percent of target payout earned for growth in net sales and NOP in each of the three years covered by the award. The ROIC modifier, which could have reduced this payout, was surpassed and did not apply.

The following is a summary of how the 89.3% of target payout was determined for the 2016 Performance RSUs.

- Annual net sales growth was above target at 8.0% for 2016 and 10.2% for 2017, and slightly below target at 6.0% for 2018. The three-year average payout earned on net sales growth was 112% of target.
- Annual NOP growth was above maximum at 19.9% for 2017, but below threshold for both 2016 and 2018 due to the impact of significant investments in our business during this period that were essential to our long-term strategy. The three-year average payout earned on NOP growth was 66% of target.
- Total payout earned was 89.3% which is an average of what was earned for net sales and NOP (weighted equally).
- Average ROIC premium vs. WACC of 73% exceeded the 30% premium threshold, so the ROIC modifier did not apply.
- Total shareholder return (TSR) was 50% for the performance period, which increased the value for shares that were earned and paid out.

The following are the annual growth goals that were established for this grant.

	% of Target Payout	Annual Growth in Net Sales	Annual Growth in NOP
Threshold	50%	4%	4%
Target	100%	7%	9%
Maximum	200%	15%	20%

Average % Difference Between ROIC and WACC	% Reduction in Target Number of RSUs
30.0% or greater	No reduction
20.0% - 29.9%	-5%
10.0% - 19.9%	-10%
0.1% - 9.9%	-15%
0% or lower	-20%

The following charts show the actual performance achieved for the performance period and how the total payout of 89.3% of target was determined.

	Net Sales ($M)	% Annual Growth	% of Target Payout
2016	$1,311	8.0%	**113%**
2017	$1,444	10.2%	**139%**
2018	$1,532	6.0%	**84%**
		Three-year average:	**112%**

	NOP ($M)	% Annual Growth	% of Target Payout
2016	$76.7	-11.5%	**0%**
2017	$91.9	19.9%	**199%**
2018	$92.4	0.6%	**0%**
		Three-year average:	**66%**

Total payout: 89.3% of target
(equal weighting of average payout earned on Net Sales and NOP)

	Return on Invested Capital (ROIC)	Weighted Average Cost of Capital (WACC)	ROIC Premium vs. WACC
2016	12.2%	7.9%	**54%**
2017	14.3%	7.7%	**86%**
2018	16.0%	8.9%	**80%**
		Three-year average:	**73%**

ROIC modifier was not applied to this payout
(Three-year average premium of 73% was above the threshold of 30%)

Other Elements of Compensation

Benefits. Our executive officers participate in the benefit programs provided to our benefit eligible team members. This includes company provided medical, dental, basic life, short-term disability, long-term disability, and a matched 401(k) savings plans. Our NEOs participate in the 401(k) on the same basis as all other team members. There is no supplemental matching program, excess plan, or other retirement program. The value of the 401(k) matching contribution made by the company for our NEOs is included in "All Other Compensation" as disclosed in the "Summary Compensation Table" on page 51.

Non-Qualified Deferred Compensation Plan. As described in more detail on page 57, our executive officers along with other leaders may elect to defer a portion of their salary, AIP payout, and Performance RSU payout under this non-qualified deferred compensation plan. The company does not make any contributions to this plan on behalf of participants. The plan offers a range of investment options for the tracking of an investment return on the deferrals, and participants can elect how their deferrals will be distributed in the future.

Executive Benefits and Perquisites. Consistent with our commitment to emphasize pay for performance in our mix of total compensation, our executive officers receive very few executive benefits and perquisites. The company has paid for a supplemental long-term disability that provided a benefit of 60% of pay in excess of the limits under the group plan. The Committee has approved the elimination of this executive benefit at the end of 2019. The company provides only two perquisites to our executive officers: financial counseling and an annual executive physical exam. The annual limit for financial counseling is $15,000 for our CEO and $8,000 for our other NEOs. The company pays for the cost after insurance coverage of an annual executive physical exam. Amounts reimbursed for financial counseling or the executive physical exam are fully taxable to the executive and there is no "gross up" by the company to cover these taxes for the executive.

Employment Agreements. We do not have employment agreements with any of our executive officers that provide for continued employment for any period of time.

Severance Plan. Our executive officers and other key leaders of the company participate in the Sleep Number Executive Severance Pay Plan. This plan provides for severance pay, prorated AIP incentive, and other benefits such as outplacement and limited COBRA reimbursement in the event of involuntary termination of employment not for cause or termination for good reason, including for events following a change-in-control, as those terms are defined in the plan. This plan is described in more detail in the section labeled "Potential Payments to Named Executive Officers" found on page 58.

Compensation Governance, 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 with shareholder interests.

Compensation Practice	Sleep Number Policy or Practice	
Pay for performance	**Yes**	A significant percentage of the total direct compensation package is performance-based.
Robust stock ownership guidelines	**Yes**	Executive officers and members of the Board of Directors are subject to stock ownership guidelines.
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 provisions	**Yes**	We have clawback provisions that allows for recovery of cash incentive awards and earned LTI payouts 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 and assist in the benchmarking of compensation levels.
Double-trigger vesting	**Yes**	If outstanding LTI grants are assumed or substituted upon a change-in-control, the vesting of the LTI grants will only be accelerated if the executive is terminated without cause or terminates with good reason within two years of the change-in-control (i.e., "double trigger vesting")
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 to our executive officers, other than for relocation benefits that are applied consistently for all team members.
LTI Grant Practices and Procedures Policy	**Yes**	We have a policy that documents the practices and procedures for making LTI grants to eligible team members including executive officers. This policy specifies approval procedures, timing of awards, and the award formulas that determine the number of options or RSUs granted.
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 NEOs has an employment contract that provides for continued employment for any period of time.

Stock Ownership. Encouraging stock ownership among our executive officers is critical in aligning their interests with those of our shareholders. The company has in place stock ownership guidelines for executive officers as well as for members of the Board of Directors. The following is the value of share ownership that is expected at various levels under these guidelines:

- 5x base salary for CEO
- 3x base salary for executive officers (other than CEO), and
- 5x annual cash retainer for Board members

According to the guidelines, the stock ownership value includes: shares owned outright, shares held in the 401(k) Plan or Deferred Compensation Plan, after tax intrinsic value of vested and outstanding stock options, after tax value of outstanding Performance RSUs (prorated to the extent that any year of the performance period has been completed and the payout for that year is known). Until the guideline is met, executives are required to hold 50% of the net shares from the vesting or payout of any LTI grant or from the exercise of stock options. Directors are expected to achieve the guideline level of ownership within five years of their appointment to the Board.

Committee and Governance. The Committee is comprised entirely of independent, non-employee Directors. The key responsibilities of the Committee as outlined in its charter 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 CEO
- Determine the composition and value of compensation for the CEO 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

The Committee usually meets four to six times per year, in person or by conference call. Our CEO, other members of our management team, 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 CEO nor any other member of our management team votes on any matters before the Committee. The Committee, however, solicits the views of our CEO 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 CEO. 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.

Role of Independent Compensation Consultant. Under its charter, the Committee has the authority to retain and consult with independent advisors to assist in fulfilling their 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 Frederic W. Cook & Co., Inc. (FW Cook) as its independent compensation consultant. At the Committee's request each year, FW Cook certifies that it continues to be an independent advisor and discloses information in a letter to the Committee that demonstrates this independence. The Committee assessed this certification and disclosure information and concluded that no conflict of interest or independence concerns exist in the engagement of FW Cook as the Committee'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 based on proxy data for our peers and other data sources to inform executive compensation levels and design
- Provides advice and guidance to the Committee on pay actions for executives

CEO Assessment Process. The Committee evaluates Ms. Ibach's performance by soliciting input from all members of the Board. 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.

Compensation Risk Assessment. Based on an annual risk 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. The results of this risk assessment were shared with the Committee.

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 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.

In September 2018, the Committee approved the addition of two new companies to the peer group on the recommendation of FW Cook. The two companies added were Conn's, Inc. and iRobot Corporation, which increased the size of the peer group to 17 companies in total. Conn's operates in a business similar to our peers and considers our company as one its peers. iRobot is aligned with our business model and focus on technology innovation for products in the home. No companies were removed from the peer group. The following is the updated listing of our peer group as of September 2018:

- Aaron's, Inc.
- Columbia Sportswear Company
- Conn's, Inc. (new)
- The Container Store Group, Inc.
- Deckers Outdoor Corporation
- Dolby Laboratories, Inc.
- Ethan Allen Interiors Inc.
- Express Inc.
- Haverty Furniture Companies Inc.
- iRobot Corporation (new)
- La-Z-Boy Incorporated
- Leggett & Platt, Incorporated
- Pier 1 Imports Inc.
- RH
- Steven Madden, Ltd.
- Tempur Sealy International, Inc.
- Vitamin Shoppe, Inc.

The peer group prior to adding these two companies was used in the competitive analysis considered for pay decisions made in March 2018.

Benchmarking. With the assistance of FW Cook, the Committee considers market data on base salary, target total cash compensation, and target total direct compensation when establishing compensation levels for executive officers. The sources for this market comparison are from peer group pay data (most recent disclosures) and certain retail or general industry surveys from third parties. For each executive, we attempt to match as closely as possible our position to what is most comparable in our peers or the surveys. This competitive analysis is just one factor considered when making pay decisions on base salary or incentive opportunities.

The Committee generally seeks to align target total direct compensation opportunities with the median of the market, while providing opportunity for top quartile compensation for performance above goal and below median compensation for performance below goal. 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.

Tax Considerations. We have historically considered the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code in our design and operation of various incentive programs including AIP and LTI. The Tax Cut and Jobs Act, signed into law on December 22, 2017 (the "Tax Act"), among other things, repealed the exemption from the $1 million compensation deduction limit under Section 162(m) 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 AIP and LTI programs 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. The Committee intends to administer the existing AIP and LTI programs, to the extent covered under the transition rule, with a view towards preserving their ability to qualify as exempt "performance-based" compensation for purposes of Section 162(m). However, the Committee does not require all compensation programs, including AIP and LTI, to be fully deductible under Section 162(m) as the Committee believes it is important to preserve flexibility in maintaining compensation programs that are aligned with our compensation philosophy. Given the Tax Act repeal of the performance-based pay exception, the Committee may design future programs and administer the existing programs in a manner that does not satisfy the requirements for an exemption from the Section 162(m) deduction limit.

We currently expect that we will continue to structure our executive compensation program consistent with our pay for performance philosophy so that a significant portion of total executive compensation is linked to the performance of our company.

Summary Compensation Table

The following table contains compensation information for the last three fiscal years relating to the named executive officers. Note that the AIP awards earned for each fiscal year are reported under the heading "Non-Equity Incentive Plan Compensation." The values shown under the headings "Stock Awards" and "Option Awards" are the grant date fair values of the awards received in each fiscal year. This does not represent what was earned or paid out for these awards due to performance. The details of our named executive officers' compensation are discussed in the Compensation Discussion and Analysis beginning on page 30.

Name And Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards[1][2] ($)	Option Awards[1] ($)	Non-Equity Incentive Plan Compensa-tion[3] ($)	All Other Compensa-tion[4] ($)	Total ($)
Shelly R. Ibach President and CEO	2018	$926,923	---	$2,158,898	$725,426	$ 589,837	$ 31,620	$4,432,704
	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
David R. Callen SVP and CFO	2018	$472,763	---	$ 377,850	$ 126,927	$ 139,111	$ 18,075	$1,134,726
	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
Andrew P. Carlin EVP, Chief Sales and Services Officer	2018	$477,326	---	$ 431,780	$ 145,099	$ 153,222	$ 18,144	$1,225,571
	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
Andrea L. Bloomquist SVP and Chief Product Officer	2018	$429,484	---	$ 323,749	$ 108,825	$ 126,376	$ 20,061	$1,008,495
	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
Kevin K. Brown SVP and Chief Marketing Officer	2018	$423,201	---	$ 323,749	$ 108,825	$ 124,527	$ 15,410	$ 995,712

(1) Reflects the aggregate grant date fair value of equity awards granted during fiscal years 2018, 2017 and 2016, 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 29, 2018, for a discussion of the relevant assumptions used in calculating these amounts.

(2) The "Stock Awards" column includes Performance RSU awards granted during fiscal years 2018, 2017, and 2016 and a special performance-vested RSU award granted during fiscal 2017. The amounts included for these awards represent the grant date fair value assuming the achievement of the performance goals for a target payout. If the Performance RSU awards granted during fiscal year 2018 had been calculated assuming that the maximum payout had been earned, the grant date fair value of these Performance RSU awards would have been as follows: for Ms. Ibach, $4,317,796; for Mr. Callen, $755,700; for Mr. Carlin, $863,560; for Ms. Bloomquist, $647,498; and for Mr. Brown, $647,498. For further information on these awards, see the "Grants of Plan-Based Awards" table and the discussion in the Compensation Discussion and Analysis under the heading "Long-Term Incentive Plan (LTI)."

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

(4) All other compensation includes the costs of (i) reimbursement for personal financial planning and tax advice; (ii) company sponsored physical exam; (iii) company matching contribution to the 401(k) Plan according to a matching formula and contribution limits that are the same for all participants; and (iv) annual premium for supplemental long-term disability coverage, which will no longer be provided by the company to executive officers after the end of fiscal year 2019.

Grants of Plan-Based Awards

The following table summarizes for each of the named executive officers the non-equity incentive award opportunity under the AIP for fiscal year 2018 and the equity awards (Performance RSUs and Options) made during the fiscal year 2018.

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards[1]			Estimated Future Payouts Under Equity Incentive Plan Awards						
Name	Grant Date	Thresh-old ($)	Target ($)	Maxi-mum ($)	Thresh-old (#)	Target (#)	Maxi-mum (#)	All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Under-lying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)[4]
Shelly R. Ibach		$220,500	$1,102,500	$2,756,250							
	3/21/18[2]				5,217	62,850	125,700				$2,158,898
	3/21/18[3]								51,095	$34.35	$ 725,426
David R. Callen		$52,004	$260,020	$650,050							
	3/21/18[2]				913	11,000	22,000				$ 377,850
	3/21/18[3]								8,940	$34.35	$ 126,927
Andrew P. Carlin		$57,279	$286,396	$715,990							
	3/21/18[2]				1,044	12,570	25,140				$ 431,780
	3/21/18[3]								10,220	$34.35	$ 145,099
Andrea L. Bloomquist		$47,243	$236,216	$590,540							
	3/21/18[2]				783	9,425	18,850				$ 323,749
	3/21/18[3]								7,665	$34.35	$ 108,825
Kevin K. Brown		$46,552	$232,761	$581,902							
	3/21/18[2]				783	9,425	18,850				$ 323,749
	3/21/18[3]								7,665	$34.35	$ 108,825

(1) This represents the cash annual incentive opportunity for 2018 under the AIP. The actual amounts earned under this plan for 2018 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 performance. If the minimum performance level for payment of the threshold amount is not achieved, then no annual incentive would be payable under the plan. See discussion in the Compensation Discussion and Analysis under the heading "Annual Incentive Plan (AIP)."

(2) This represents Performance RSU awards described in greater detail in the Compensation Discussion and Analysis under the heading, "Long-Term Incentive Plan (LTI)." The target number of Performance RSUs will be adjusted based on company performance against annual growth goals over a three-year performance period covering fiscal years 2018, 2019 and 2020. There can also be a reduction in the target number of Performance RSUs for ROIC performance below a threshold. Performance RSUs are also subject to a three-year vesting requirement from the grant date. If any dividends are paid on our common stock, the holders of the Performance RSUs would receive dividends at the same rate as paid to other shareholders if and when the Performance RSU award is earned and becomes fully vested.

(3) These awards represent stock options described in greater detail in the Compensation Discussion and Analysis under the heading, "Long-Term Incentive Plan (LTI)." 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 vest in three equal annual installments on each of the anniversaries following 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.

(4) Reflects the grant date fair value computed in accordance with FASB ASC Topic 718. The value for Performance RSU awards reflects the target award value.

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 29, 2018.

	Option Awards				Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)(9)	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 ($)(9)
Shelly R. Ibach	7,500	---	$ 0.79	6/18/2019	---	---	---	---
	6,875	---	$ 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	---	---	---	---
	29,480	---	$33.32	3/16/2025	---	---	---	---
	38,527	19,263(1)	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	75,862(2)	$2,437,446	---	---
	17,907	35,813(4)	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	69,300(5)	$2,226,609
	---	---	---	---	---	---	138,595(6)	$4,453,057
	---	51,095(7)	$34.35	3/21/2028	---	---	---	---
	---	---	---	---	---	---	62,850(8)	$2,019,371
David R. Callen	7,395	---	$17.36	4/7/2024	---	---	---	---
	4,420	---	$33.32	3/16/2025	---	---	---	---
	7,340	3,670(1)	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	14,449(2)	$464,246	---	---
	3,867	7,733(4)	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	14,960(5)	$ 480,665
	---	---	---	---	---	---	14,700(6)	$ 472,311
	---	8,940(7)	$34.35	3/21/2028	---	---	---	---
	---	---	---	---	---	---	11,000(8)	$ 353,430
Andrew P. Carlin	2,611	---	$25.99	6/1/2022	---	---	---	---
	11,450	---	$21.15	4/1/2023	---	---	---	---
	9,350	---	$17.77	3/28/2024	---	---	---	---
	5,895	---	$33.32	3/16/2025	---	---	---	---
	7,340	3,670(1)	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	14,449(2)	$464,246	---	---
	---	---	---	---	18,880(3)	$606,614	---	---
	4,884	9,766(4)	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	18,900(5)	$ 607,257
	---	---	---	---	---	---	14,700(6)	$ 472,311
	---	10,220(7)	$34.35	3/21/2028	---	---	---	---
	---	---	---	---	---	---	12,570(8)	$ 403,874

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 ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($) [9]	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 ($) [9]
Andrea L. Bloomquist	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	---	---	---	---
	5,895	---	$33.32	3/16/2025	---	---	---	---
	7,340	3,670[1]	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	14,449[2]	$ 464,246	---	---
	3,867	7,733[4]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	14,960[5]	$ 480,665
	---	---	---	---	---	---	14,700[6]	$ 472,311
	---	7,665[7]	$34.35	3/21/2028	---	---	---	---
	---	---	---	---	---	---	9,425[8]	$ 302,825
Kevin K. Brown	6,230	---	$17.77	3/24/2024	---	---	---	---
	4,420	---	$33.32	3/16/2025	---	---	---	---
	5,503	2,752[1]	$18.81	3/22/2026	---	---	---	---
	---	---	---	---	10,837[2]	$ 348,193	---	---
	2,645	5,290[4]	$23.61	3/21/2027	---	---	---	---
	---	---	---	---	---	---	10,235[5]	$ 328,851
	---	---	---	---	---	---	14,700[6]	$ 472,311
	---	7,665[7]	$34.35	3/21/2028	---	---	---	---
	---	---	---	---	---	---	9,425[8]	$ 302,825

(1) 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.

(2) These Performance RSU awards were granted on March 22, 2016 and will become vested on March 22, 2019, subject to continuing employment through the applicable vesting date. The number of shares shown above reflects the actual payout that was earned for the 2016 Performance RSUs based on the performance period that covers fiscal years 2016, 2017 and 2018. The payout for the 2016 Performance RSU awards is described in greater detail in the Compensation Discussion and Analysis under the heading, "Long-Term Incentive Plan (LTI)."

(3) These restricted stock units were granted on April 11, 2016 and will become vested on April 11, 2019, subject to continuing employment through the applicable vesting date.

(4) 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.

(5) These Performance RSU awards were granted on March 21, 2017 and will become vested on March 21, 2020, subject to achieving performance criteria and continuing employment through the vesting date. The number of shares shown above reflects the target award level. The performance period for this award covers fiscal years 2017, 2018 and 2019.

(6) These special performance-vested restricted 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 special EPS target for fiscal 2019 and continuing

employment through the vesting date. In addition, the restricted stock units that are earned for achievement of the special EPS target can be reduced by 15% if the total shareholder return threshold for the performance period is not met. The shares shown above are reflected at the target award level, which is the same as the maximum award level. The performance period for this award is a special EPS target for fiscal 2019.

(7) These stock options were granted on March 21, 2018 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.

(8) These Performance RSU awards were granted on March 21, 2018 and will become vested on March 21, 2021, subject to achieving performance criteria and continuing employment through the vesting date. The number of shares shown above reflects the target award level. The performance period for this award covers fiscal years 2018, 2019 and 2020.

(9) Calculated by multiplying unvested stock awards by $32.13, the closing price of the company's common stock on the Nasdaq Stock Market on December 28, 2018, the last trading day of fiscal year 2018.

Option Exercises and Stock Vested

The following table summarizes the stock options that were exercised and the stock awards that became vested for each of the named executive officers during the fiscal year ended December 29, 2018.

	Option Awards		**Stock Awards**	
Name	**Number of Shares Acquired on Exercise (#)**	**Value Realized on Exercise ($)(1)**	**Number of Shares Acquired on Vesting (#)(2)**	**Value Realized on Vesting ($)(3)**
Shelly R. Ibach	27,110	$ 596,820	40,407(4)	$1,447,783
David R. Callen	---	---	6,060(4)	$ 217,130
Andrew P. Carlin	14,599	$ 306,725	8,082	$ 289,578
Andrea L. Bloomquist	17,875	$ 403,515	8,082	$ 289,578
Kevin K. Brown	---	---	6,060	$ 217,130

(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 amounts shown in these columns represented the number of shares that were earned and paid out for the 2015 Performance RSU award that covered the performance period of fiscal years 2015, 2016, and 2017 and became vested on March 16, 2018.

(3) The value realized for purposes of this table is based on the fair market value of our common stock on the date of vesting of the 2015 Performance RSU award.

(4) Under the company's Deferral Plan (described in the Nonqualified Deferred Compensation table below), Ms. Ibach deferred the receipt of 39,083 shares until the earlier of March 16, 2021 or the termination of her employment and Mr. Callen deferred the receipt of 5,862 shares until the earlier of March 16, 2020 or the termination of his employment. The value of these deferred shares realized on vesting is based on the closing stock price on the vesting date, regardless of whether the payout had been deferred. The actual value of the deferred shares when paid out in the future may be different than the value reflected in this table. The value realized on vesting is also reflected in the "Executive Contributions in Last Fiscal Year" column in the Nonqualified Deferred Compensation table below.

Nonqualified Deferred Compensation

Named executive officers are eligible to participate in the Sleep Number Executive Deferral Plan ("Deferral Plan"), a non-qualified deferred compensation plan. The Deferral Plan allows executives to defer payment of up to 50% of their base salary, 75% of their AIP payout, and 100% of their payout from Performance RSUs or other stock awards. At the time that executives make their deferral election, they choose whether their deferrals will be paid out in a lump sum or up to ten annual installments following their termination of employment. For salary or AIP deferrals, executives choose how to allocate their deferrals across a range of notional investment alternatives that are similar to the investment fund options in the company's 401(k) Plan. The executive's deferral account is credited with the earnings as if there was a deemed investment in the notional investment alternatives offered for the Deferral Plan. For RSU deferrals, the amounts deferred are tracked in deferred share units, and distributions are settled in shares of common stock.

The following table summarizes for each named executive officer their contributions, earnings, and balance for the Deferral Plan for the fiscal year ended December 29, 2018. Note that the company does not make any contributions to the Deferral Plan on behalf of participants.

Name	Executive Contributions in Last Fiscal Year[(1)] ($)	Registrant Contributions in Last Fiscal Year ($)	Aggregate Earnings in Last Fiscal Year[(2)] ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last Fiscal Year-End[(3)] ($)
Shelly R. Ibach	$2,535,906	---	($233,397)	---	$3,254,018
David R. Callen	$210,035	---	($24,845)	---	$223,594
Andrew P. Carlin	$368,926	---	$20,978	---	$1,435,392
Andrea L. Bloomquist	---	---	---	---	---
Kevin K. Brown	$474	---	($2,384)	---	$53,324

(1) The amounts in this column represent deferred amounts credited to the executive's deferral accounts during fiscal year 2018. This included base salary deferrals that are included in the "Salary" column of the "Summary Compensation Table" for 2018 as follows: for Ms. Ibach, $451,730; for Mr. Carlin, $238,221; and for Mr. Brown, $474.

(2) These amounts represent the total aggregate notional earnings for fiscal year 2018 for the executive's deferral account under the Deferral Plan. These are notional earnings based on how the executive has elected to direct their salary or AIP deferrals to various investment alternatives, and the actual market return of that investment alternative for the year. For RSU deferrals, earnings represent the change in market value of the deferred share units held in the executive's deferral account.

(3) This is the aggregate market value of the executive's deferral account under the Deferral Plan as of the end of fiscal year 2018.

Potential Payments Upon Termination or Change in Control

This section describes the potential payments that would be made to the named executive officers under various employment termination scenarios as if they occurred at the end of fiscal year 2018 (as of December 29, 2018). The values shown in the table are calculated as of this date based on certain estimates or assumptions as described in the footnotes. The actual amounts received may differ materially from those shown in the table. The table does not include amounts already vested that the executive would receive if he or she left the company for any reason, such as the fully vested balance of an executive's deferral account, gains from outstanding options that are exercisable, or payments and benefits that are provided on a non-discriminatory basis to salaried team members generally upon termination.

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. Executive officers do not have employment agreements, and do not have any contractual or other right to employment for any term or period of time. In addition, executive officers are only eligible for the severance pay and other benefits as provided under the company's Executive Severance Pay Plan as shown in the table and described in the footnotes.

The table below shows information about the acceleration of option or stock awards in the event of a change in control as defined under the company's Amended and Restated 2010 Omnibus Incentive Plan (the "2010 Plan"). The 2010 Plan contains a "double-trigger" change in control provision. Under this provision, if outstanding option or stock awards are assumed or substituted following a change in control, vesting of the option or stock awards is only accelerated in the event of involuntary termination not for cause or resignation for good reason of the team member, as those terms are defined under the 2010 Plan. This is provided that the team member's termination of employment occurs within two years of the change in control.

Vesting of option or stock awards may also be accelerated in the event a named executive officer qualifies for retirement treatment under the terms of the award agreements and the 2010 Plan. If an executive is at least age fifty-five (55) and has five (5) or more years of service at retirement, the vesting will be accelerated on a pro-rata portion of their option or stock award based on the portion of the vesting period that was actually worked through the date of retirement. For option and stock awards granted beginning in fiscal 2017, an additional retirement provision was added. If an executive is at least age sixty (60) and has five (5) or more years of service at retirement, there is a full acceleration of vesting of the option or stock award provided that the executive gives a one-year notice of their intention to retire. This additional acceleration of vesting provision does not apply to any option or stock award granted within less than a year of retirement. The special performance-vested restricted stock units that were granted on March 21, 2017 have different retirement treatment than other stock awards. If an executive is at least age sixty (60) and has five (5) or more years of service at retirement, the vesting will be accelerated on a pro-rata portion of the award earned with performance based on the number of full months in the performance period that were actually worked through the date of retirement.

Name	Type of Payment	Voluntary Termination ($)	For Cause Termination ($)	Involuntary Termination (No Change in Control) ($)	Involuntary Termination (Following Change in Control) [1] ($)	Death or Disability ($)
		Triggering Events				
Shelly R. Ibach	Cash Severance [2]	---	---	$ 4,195,000	$ 6,285,000	---
	Option Award Acceleration [3]	$ 316,264	---	$ 316,264	$ 561,710	$ 561,710
	Stock Award Acceleration [4]	$ 4,360,394	---	$ 4,360,394	$ 11,428,512	$11,428,512
	Benefit Reimbursement [5]	---	---	$ 9,671	$ 9,671	---
	Executive Disability [6]	---	---	---	---	$ 3,847,529
	Total	$ 4,676,658	---	$ 8,881,329	$18,284,893	$15,837,751
David R. Callen	Cash Severance [2]	---	---	$ 759,933	$ 1,509,867	---
	Option Award Acceleration [3]	---	---	---	$ 114,770	$ 114,770
	Stock Award Acceleration [4]	---	---	---	$ 1,826,269	$ 1,826,269
	Benefit Reimbursement [5]	---	---	$ 11,436	$ 11,436	---
	Executive Disability [6]	---	---	---	---	$ 2,312,752
	Total	---	---	$ 771,369	$ 3,462,342	$ 4,253,791
Andrew P. Carlin	Cash Severance [2]	---	---	$ 782,208	$ 1,554,416	---
	Option Award Acceleration [3]	$ 69,942	---	$ 69,942	$ 132,091	$ 132,091
	Stock Award Acceleration [4]	$ 1,493,274	---	$ 1,493,274	$ 2,609,920	$ 2,609,920
	Benefit Reimbursement [5]	---	---	$ 11,189	$ 11,189	---
	Executive Disability [6]	---	---	---	---	$ 2,003,872
	Total	$ 1,563,216	---	$ 2,356,613	$ 4,307,616	$ 4,745,883
Andrea L. Bloomquist	Cash Severance [2]	---	---	$ 680,205	$ 1,350,409	---
	Option Award Acceleration [3]	---	---	---	$ 114,770	$ 114,770
	Stock Award Acceleration [4]	---	---	---	$ 1,775,664	$ 1,775,664
	Benefit Reimbursement [5]	---	---	---	---	---
	Executive Disability [6]	---	---	---	---	$ 2,784,440
	Total	---	---	$ 680,205	$ 3,240,843	$ 4,674,874
Kevin K. Brown	Cash Severance [2]	---	---	$ 671,836	$ 1,333,672	---
	Option Award Acceleration [3]	---	---	---	$ 81,727	$ 81,727
	Stock Award Acceleration [4]	---	---	---	$ 1,493,884	$ 1,493,884
	Benefit Reimbursement [5]	---	---	$ 11,189	$ 11,189	---
	Executive Disability [6]	---	---	---	---	$ 2,735,137
	Total	---	---	$ 683,025	$ 2,920,472	$ 4,310,748

(1) 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.

(2) Our named executive officers are participants in the company's Executive Severance Pay Plan. Under this plan, a participant is eligible for severance pay and other benefits in the event of involuntary termination not for cause or resignation for good reason ("qualifying termination"), as those terms are defined under the plan. There is no severance pay benefit for voluntary termination or involuntary termination for cause. As a condition of receiving any severance pay under the plan, the executive must agree to a general release of claims against the company. The amount of the severance pay payable for a qualifying termination is a multiple of the sum of the executive's annual base salary plus the target annual incentive award under AIP, as of the date of termination. For Ms. Ibach, the multiple is two times and for all other NEOs, the multiple is one times. If the qualifying termination occurs within a period starting six months before a change in control event and ending two years after a change in control event, the multiple would be as follows: For Ms. Ibach, three times; for all other NEOs, two times. In order to receive the additional severance pay for qualifying terminations after a change in control, the executive must agree to refrain from certain restricted activities for an extended period of two years after termination of employment. The plan defines restricted activities to include certain competitive and solicitation activities. Severance pay benefits are paid in a lump sum following termination of employment. The cash severance amounts shown above were calculated using annual base salary and target annual incentive for AIP in effect for each executive as of the end of fiscal 2018. Also under the plan, participants are eligible for outplacement services. The maximum value of this benefit is included in the cash severance amounts shown above. The plan does provide for a pro-rata annual incentive award under AIP for the period of the year that the participant was actively employed. The calculations for this table are as of the end of the fiscal year, which is when participants in the AIP become eligible for the full incentive award earned for that fiscal year. As a result, the table does not include any value for a pro-rata annual incentive.

(3) The value of the 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 28, 2018 ($32.13), 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 29, 2018 was $18.81 to $34.35. For voluntary termination when an executive is eligible for retirement treatment (age 55 and five or more years of service), the number of unvested stock options is prorated in valuing the acceleration of vesting.

(4) The value of the acceleration of the vesting of stock awards held by a named executive officer is based on: (i) the number of unvested stock awards or target Performance RSUs held by the executive as of December 29, 2018, multiplied by (ii) the fair market value of our common stock on December 28, 2018 ($32.13). For voluntary termination when an executive is eligible for retirement treatment (age 55 and five or more years of service), the number of unvested stock awards or target Performance RSUs is prorated in valuing the acceleration of vesting.

(5) For a qualifying termination under the Executive Severance Pay Plan, a named executive officer is eligible to receive a reimbursement equal to the difference in cost between the monthly COBRA premium and the monthly cost for the medical plan coverage while an active team member. The reimbursement is for as long as the executive is covered by COBRA but for a period not to exceed two years for Ms. Ibach and one year for all other NEOs.

(6) Our named executive officers are eligible for supplemental long-term disability coverage that is paid for the company. This benefit coverage is in addition to the long-term disability coverage provided under the company's group plan that is provided to all benefit eligible team members. The amounts shown above represent the estimated present value of the supplemental disability benefit for each named executive officer assuming that the benefit payment had commenced on December 29, 2018 and had been paid until age 65. A discount rate of 3% per year was used in the present value calculation. Note that the supplemental long-term disability coverage will no longer be provided by the company to executive officers after the end of fiscal year 2019.

CEO Pay Ratio

As required by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, we are providing the following information about the relationship of the annual total compensation of our team members and the annual total compensation of our CEO. For fiscal year 2018 ending on December 29, 2018, we identified that the annual total compensation of the team member identified as the median was $52,306, and the annual total compensation of the CEO, as reported in the Summary Compensation Table, was $4,432,704. Based on this information, the 2018 ratio of the annual total compensation of our CEO to the median annual total compensation of all team members was estimated to be 85 to 1.

The following is a summary of the methodology and assumptions used in determining the median annual total compensation of our team members for 2018:

- We used our total active team member population as of the end of fiscal year 2018.
- For measuring total compensation of our team members, we included base wages, incentive compensation, commissions, over-time, paid time off, and holiday pay that was actually paid to each team member during fiscal year 2018.
- For team members included in the population that were hired during fiscal year 2018, we annualized their actual total compensation to consider that they worked for only a portion of the year.

It should be noted 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 total compensation included, any assumptions made and the use of statistical sampling. In addition, no two companies have identical employee populations or compensation programs. As such, our pay ratio may not be comparable to the pay ratio reported by other companies.

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 2018 fiscal year ended December 29, 2018.

Name	Fees Earned or Paid in Cash ($)	Stock Awards[1] ($)	Option Awards[2] ($)	All Other Compensation ($)	Total ($)
Daniel I. Alegre	$ 83,500	$77,807	$26,077	---	$187,384
Stephen L. Gulis, Jr.[3]	$ 89,500	$77,807	$26,077	$ 222	$193,606
Michael J. Harrison	$ 85,000	$77,807	$26,077	---	$188,884
Deborah L. Kilpatrick, Ph.D.[5]	$ 62,500	$77,807	$26,077	---	$166,384
Brenda J. Lauderback[3]	$ 96,000	$77,807	$26,077	---	$199,884
Barbara R. Matas [3][4]	$ 90,500	$77,807	$26,077	$ 4,318	$198,702
Kathleen L. Nedorostek [4]	$ 85,000	$77,807	$26,077	---	$188,884
Vicki A. O'Meara	$ 83,000	$77,807	$26,077	$ 2,818	$189,702
Michael A. Peel[3]	$ 97,000	$77,807	$26,077	---	$200,884
Jean-Michel Valette	$195,000	$77,807	$26,077	---	$298,884

(1) Reflects the aggregate grant date fair value of 2,696 restricted stock awards granted during fiscal year 2018, computed in accordance with FASB ASC Topic 718. See Note 8, *Shareholders' Equity*, to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 29, 2018, for a discussion of the relevant assumptions used in calculating these amounts. As of December 29, 2018, 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 2018 was as follows: Mr. Alegre, 2,696 shares; Mr. Gulis, 69,582 shares; Mr. Harrison, 16,713 shares; Ms. Kilpatrick, 2,696 shares; Ms. Lauderback, 11,951 shares; Ms. Matas, 13,469 shares; Ms. Nedorostek, 17,289 shares; Ms. O'Meara, 2,696 shares; Mr. Peel, 15,202 shares, and Mr. Valette, 2,696 shares.

(2) Reflects the aggregate grant date fair value of 2,165 stock option awards granted during fiscal year 2018, computed in accordance with FASB ASC Topic 718. See Note 8, *Shareholders' Equity*, to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 29, 2018, for a discussion of the relevant assumptions used in calculating these amounts. As of December 29, 2018, the aggregate number of stock options outstanding held by those who served as non-employee Directors during fiscal 2018 was as follows: Mr. Alegre, 13,522; Mr. Gulis, 24,397; Mr. Harrison, 16,991; Ms. Kilpatrick, 2,165; Ms. Lauderback, 24,397; Ms. Matas, 6,287; Ms. Nedorostek, 19,397; Ms. O'Meara, 6,287; Mr. Peel 30,760; and Mr. Valette, 24,397.

(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 2018, the following Directors have elected to defer receipt of their 2018 Incentive Award: Mr. Gulis, 2,696 shares; Ms. Lauderback, 2,696 shares; Ms. Matas, 1,348 shares; and Mr. Peel, 2,696 shares.

(4) Ms. Matas and Ms. Nedorostek 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 Ms. Matas in lieu of cash payments during fiscal 2018 is 2,595 shares and the related grant date fair value was $90,500. The number of shares to be received by Ms. Nedorostek in lieu of cash payments during fiscal 2018 is 2,501 shares and the related grant date fair value was $87,000.

(5) Ms. Kilpatrick elected to receive a portion of Director fees in the form of common stock under the company's 2010 Omnibus Incentive Plan. The number of shares paid is determined by dividing the amount of the Director's fees to be received in the form of common stock 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 received by Ms. Kilpatrick in lieu of cash payments during fiscal 2018 was 1,376 shares and the related grant date fair value was $46,804.

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	2,841,781[(2)]	$22.64	2,335,638
Equity compensation plans not approved by security holders	None	Not applicable	None
Total	2,841,781	$22.64	2,335,638

(1) Includes the Sleep Number Corporation 2004 Stock Incentive Plan and the Sleep Number Corporation 2010 Omnibus Incentive Plan.

(2) This amount includes 383,181 restricted stock units, 784,881 performance-based stock units, 275,922 market-based stock units, and 75,950 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 stock appreciation rights 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 being provided to our shareholders as required pursuant to Section 14A of the Securities Exchange Act and 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 the company's 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 2019 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 2019 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. Barbara R. Matas (Chair), Stephen L. Gulis, Jr. and Vicki A. O'Meara served on the Audit Committee throughout 2018 and through the date of this report. Brenda J. Lauderback served on the Audit Committee from the beginning of 2018 and through the annual meeting of shareholders in May of 2018. Deborah L. Kilpatrick, Ph.D., joined the Audit Committee upon her appointment to the Board in May of 2018 and has continued to serve on the Audit Committee through the date of this report.

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 2018 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 2018. 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 29, 2018, 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

Barbara R. Matas, Chair
Stephen L. Gulis, Jr.
Deborah L. Kilpatrick, Ph.D.
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 2019 fiscal year ending December 28, 2019. 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 2019 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 2018 and 2017 were:

	2018	**2017**
Audit fees (1)	$651,000	$585,805
Audit-related fees (2)	1,895	1,895
Audit and audit-related fees	652,895	$587,700
Tax fees (3)	145,697	98,182
All other fees (4)	-	33,673
Total	$798,592	$719,555

(1) Audit fees in 2018 and 2017 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 29, 2018 and December 30, 2017, 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.

(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 2018 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 2019 fiscal year ending December 28, 2019. 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 2018 fiscal year ended December 29, 2018 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 2020 Annual Meeting of Shareholders must (i) be received by our Senior Vice President, Chief Legal and Risk Officer and Secretary on or before December 4, 2019 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 2020 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 4, 2019. 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 2018 Annual Report

We will furnish to our shareholders without charge a copy of our Annual Report on Form 10-K (without exhibits) for the 2018 fiscal year ended December 29, 2018. 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

Instructions for Virtual Meeting Participation

Our Annual Meeting will again be a completely virtual meeting. There will be no physical meeting location.

To participate in the virtual meeting, visit www.virtualshareholdermeeting.com/SNBR2019 and enter the 16-digit control number included on your Notice of Internet Availability of the Proxy Materials, on your proxy card, or on the instructions that accompanied your proxy materials. You may log into the meeting platform beginning at 8:15 a.m. Central Time on May 15, 2019. The meeting will begin promptly at 8:30 a.m. Central Time on May 15, 2019.

The virtual meeting platform is fully supported across browsers (Internet Explorer, Firefox, Chrome, and Safari) and devices (desktops, laptops, tablets, and cell phones) running the most updated version of applicable software and plugins. Participants should ensure that they have a strong WiFi connection wherever they intend to participate in the meeting. Participants should also give themselves plenty of time to log in and ensure that they can hear streaming audio prior to the start of the meeting.

If you wish to submit a question, you may do so during the meeting at www.virtualshareholdermeeting.com/SNBR2019.

Questions pertinent to meeting matters will be recognized and answered during the meeting, subject to time constraints. We reserve the right to edit or reject questions that are profane or otherwise inappropriate. Detailed guidelines for submitting written questions during the meeting will be available at www.virtualshareholdermeeting.com/SNBR2019. Appropriate questions pertinent to meeting matters that cannot be answered during the meeting due to time constraints will be posted and answered online at www.ir.sleepnumber.com and be available as soon as practical after the meeting.

If you encounter any technical difficulties accessing the virtual meeting platform during the check-in process or during the meeting, please call the technical support number that will be posted on the virtual meeting platform log-in page. An international technical support number will also be listed.

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

Samuel R. Hellfeld
Senior Vice President,
Chief Legal and Risk Officer and Secretary

April 2, 2019
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 29, 2018

☐ **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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	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 June 30, 2018, was $604,888,000 (based on the last reported sale price of the Registrant's common stock on that date as reported by NASDAQ).

As of January 26, 2019, there were 30,522,000 shares of the Registrant's Common Stock outstanding.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement to be furnished to shareholders in connection with its 2019 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.

Sleep Number®, SleepIQ®, Sleep Number 360®, 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®, Responsive Air®, Sleep Number Inner Circle®, Sleep30®, Smart Bed For Smart Kids®, Smart Bed Technology®, Tech-e®, 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™, RespiratoryIQ™, Sleep For The Future℠, Sleep Is Training™, This Is Not A Bed™, WellnessIQ™, ActiveComfort™, Comfortable. Adjustable. Affordable.™, CoolFit™, DualAir™, DualTemp™, Firmness Control™, FlexFit™, In Balance™, Partner Snore™, the SleepIQ LABS logo, The Bed Reborn™, The Bed That Moves You™, The Best Bed For Couples™, 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 was a 53-week year.

TABLE OF CONTENTS

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 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, based in Minneapolis, Minnesota, was founded in 1987 and became publicly traded in 1998. 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, exclusive retail distribution and lifelong customer relationships.

As a purpose-driven brand and the leader in sleep innovation, Sleep Number delivers proven quality sleep through effortless, adjustable comfort and biometric sleep tracking. We are visionary leaders in sleep and wellness and are redefining what consumers should expect from their bed. Our vertically integrated business model and role as the exclusive designer, manufacturer, marketer, retailer and servicer of Sleep Number® beds allows us to offer consumers high-quality, individualized sleep solutions and services. As a direct-to-consumer brand, we offer a cohesive experience across our Sleep Number® stores, online at SleepNumber.com and via phone at (800)753-3768. We also offer mattress home-delivery/installation and maintain an in-house customer service department.

In 2018, we revolutionized sleep with our complete line of Sleep Number 360® smart beds. The 360® smart bed, at the forefront of the digital health and wellness revolution, is rapidly becoming the "hub" for a healthy life by delivering proven quality sleep. It is the only bed in the world that offers SleepIQ® technology, a proprietary sensor technology that tracks each sleeper's individual data, including movement, breathing rate, heartbeat and sleep habits. The SleepIQ technology platform captures over 8.5 billion biometric data points every night, building one of the most comprehensive databases of biometric sleep data in the world. Today, the 360 smart bed uses this data to automatically adjust the comfort of the bed for proven quality sleep. In the future, this high-quality data will likely enable customers to use their smart bed to manage their health and wellness. Through daily digital interactions that build lifelong relationships, SleepIQ technology also communicates how you slept and provides insight into what adjustments you can make, including adjusting your Sleep Number® setting, to optimize your sleep and improve your daily life.

Our commitment to quality, value and service has been widely recognized, including being ranked #1 in Customer Satisfaction with Mattresses by J.D. Power in 2018 and the best in six out of seven categories (support, durability, comfort, variety of features, value and warranty). Sleep Number has received the highest score in the 2015, 2016 and 2018 Mattress Satisfaction Report. Sleep Number ranked 27 points above the industry average in 2018.

We are committed to delivering superior shareholder value by: (1) increasing consumer demand; (2) leveraging our business model; and (3) deploying capital efficiently. Over the past six years, we have transformed the business with $481 million of capital expenditures and acquisitions, while building vital new demand-driving capabilities. This effort has positioned us for accelerated profits and cash generation. In 2018, we increased net sales by 6% to $1.53 billion and increased earnings per diluted share by 24% to $1.92.

Social Impact Commitment

Because excellent sleep is essential to a healthier and happier society, we are committed to helping future generations achieve quality sleep. In 2018, we announced a social impact commitment to help one million young people achieve life-changing sleep through our products and sleep expertise by 2025. Since announcing this commitment, we have already donated more than $1 million and helped to improve the lives of nearly 100,000 youth through our partnerships with Good360, GenYOUth and the Alliance for a Healthier Generation.

Proprietary Sleep Innovations

As the creator and leader of the "sleep tech" category, Sleep Number introduced the revolutionary Sleep Number 360 smart bed at the Consumer Electronics Show (CES) in 2017 and completed the transition to all 360 smart beds in 2018. The winner of 13 CES innovation awards and the Edison Award for breakthrough product design and innovation in the Wellness Technology category, the 360 smart bed uses the sleeper's movements and biometrics to automatically adjust the bed's firmness throughout the night, providing the highest quality sleep.

Unlike the "one-size-fits-all" solution offered by other mattress brands, the Sleep Number 360 smart bed offers individualized comfort that is adjustable on each side of the bed. Our proprietary DualAir™ technology features two independent air chambers and allows couples to adjust firmness to their individual preference at the touch of a button. Each sleeper can set their ideal firmness, support and pressure-relieving comfort – their Sleep Number® setting – for deep, restful sleep.

SleepIQ technology, our proprietary sleep tracking technology, is the bed's operating system. It measures the user's sleep, continuously gathering hundreds of biometric readings per second, including average heart rate, breathing rate and movement. Using these measurements, the 360 smart bed automatically adjusts the firmness to keep each sleeper comfortable throughout the night. This data also enables our proprietary algorithm to deliver a daily SleepIQ® score from 1 to 100, helping sleepers understand how restful their sleep was the night before. Over time, we expect SleepIQ technology to provide individualized insights so the sleeper knows how to improve their health and wellness.

The Sleep Number 360 smart bed includes additional smart features, like foot warming, which gently warms your feet to help you fall asleep faster. The 360 smart bed also connects seamlessly with other smart devices, like the Nest Learning Thermostat™ and fitness trackers like Apple® HealthKit or Fitbit®, to help sleepers understand how daily activities impact their sleep. The Sleep Number 360 smart bed is more than just a bed – it's the center of health and wellness.

The Sleep Number 360 smart bed is available at our Sleep Number stores and online at SleepNumber.com, with pricing starting at $999. We offer our beds in good, better and best price ranges within the premium mattress category. Our Classic, Performance and Innovation lines come in a broad range of sizes, including twin, full, queen, eastern king and California king.

Additional Sleep Number Innovations

We also offer a full line of exclusive FlexFit™ smart adjustable bases that allow customers to raise the head or foot of the bed. Our industry-leading FlexFit bases seamlessly integrate with SleepIQ to deliver features like our Partner Snore™ technology, which allows your partner to press a button and raise the head of the bed to temporarily relieve snoring.

The SleepIQ Kids® k2 bed extends Sleep Number's DualAir adjustability and SleepIQ technology to the children's mattress market. The k2 bed adjusts with children as they grow, giving them the best possible sleep.

Our exclusive Sleep Number® bedding collection features a full line of sleep products that are designed to help you get better sleep. Sleep Number has a wide assortment of pillows designed to fit each individual's size, shape and sleeping position for a more comfortable sleep.

We also offer a wide assortment of temperature-balancing products including the DualTemp® layer. This proprietary sleep innovation features active air technology that allows each sleeper to select their ideal temperature at the simple touch of a button and can be used with any mattress brand or adjustable base.

Exclusive Distribution

Over 99% of our net sales are generated by our direct-to-consumer business, through a cohesive experience across our Sleep Number stores, online at SleepNumber.com and via phone.

As the exclusive distributor of Sleep Number products, 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. Since 2012, we have overhauled our direct-to-consumer distribution strategy, repositioning a large percentage of our mall stores to stronger, out-of-mall locations, improving the size and positioning within each location and adding stores in both existing and new markets. As of December 29, 2018, there were 579 Sleep Number stores in all 50 states, 41% more than six years ago. Approximately 55% of our stores (including remodels) are less than five years old. With these investments, we created an exclusive, value-added retail in-store experience through award-winning store design, technology enhancements and stores that are about 50% larger on average.

Our sleep experts in each store recognize that sleep is not "one size fits all" and provide individualized sleep solutions for each person. Shopping online is easy, too, at SleepNumber.com. Working in conjunction with our retail stores, we have a cohesive online experience that helps customers easily research our products and solutions, find and purchase products online, and receive post-sales support. Our omni-channel experience expands our digital brand, connecting with consumers to drive deeper awareness, consideration and engagement.

Our retail stores accounted for 91.5% of our net sales in 2018. Average annual net sales per store, based on Company-Controlled comparable sales, were $2.7 million in 2018. In 2018, 98% of our stores open for a full year, generated net sales over $1 million and 65% of our stores open for a full-year generated net sales over $2 million. We now have 25% of our stores delivering greater than $3 million in annual net sales. In 2018, our online and phone sales accounted for 7.6% of our net sales and increased double digits year-over-year. Wholesale/Other channel accounted for 0.9% of our net sales in 2018.

Marketing

We use a wide-ranging set of marketing and advertising instruments to expand brand reach, drive emotional brand engagement and create lifelong customer relationships. This relationship with our customers is an effective driver of repeat purchases and new customers referrals. Our marketing efforts target a broad customer demographic: 35-64 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, awareness, consideration and ongoing engagement through integrated and authentic communications that amplify the value of the 360 smart bed. This results in increased quality traffic to our website and stores. Our advertising communications use 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. Our in-house digital capabilities, content marketing, user experience and data-driven tools allow us to optimize media investment, messages and audience in real-time. In 2018, media expense represented 13.7% of net sales.

In early 2018, we entered into a multi-year, strategic partnership as the Official Sleep and Wellness Partner of the National Football League (NFL) to broaden brand reach and engagement, amplify the benefits of our 360 smart beds and link quality sleep to performance. We also established partnerships with the NFL Players Associations (NFLPA) and the Professional Football Athletic Trainers Society (PFATS). After year one of our partnership with the NFL, most active NFL players have Sleep Number 360 smart beds, which are helping players compete more effectively by measuring, understanding and maximizing the benefits of a great night's sleep. Sleep Number will continue to work with the NFL, the NFLPA, PFATS, trainers, teams and players 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 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 multiple 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 to customers' homes. Since 2017, we have opened three assembly distribution centers to assemble beds prior to delivery: Irmo, South Carolina, Salt Lake City, Utah and Baltimore, Maryland. We expect to expand this capability to approximately six assembly distribution centers over the next few 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

In July 2018, we completed the transition of our entire core mattress line to 360 smart beds. With this change, 100% of our 360 smart beds sold are now delivered and installed by our home delivery technicians or by our third-party service providers in certain markets.

Customer Service

Through our U.S.-based, in-house customer service team, we provide direct post-purchase support and are able to develop one-to-one relationships that improve the customer experience and drive our business. This team provides service and support via phone, email, "live chat" and social media. They also provide a unique opportunity to gather insights that help us continuously improve our product, strengthen our service quality and advance our innovation. This integration enables operational synergies and drives organizational efficiencies.

Research and Development

As the leader in consumer-driven sleep innovation, Sleep Number conducts extensive research to understand consumers' needs and operates R&D facilities in San Jose, California and Minneapolis, Minnesota. This research drives the design and delivery of our award-winning sleep innovations, our customer experience and our proprietary SleepIQ technology. As consumers are rapidly adopting new digital tools and using their personal data to improve health and wellness, developing new technology that improves the quality of sleep and overall wellness of our customers will remain a top priority for Sleep Number. Our research and development expenses were $29 million in 2018, $28 million in 2017 and $28 million in 2016.

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 (ERP) 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 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 February 2037 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®, 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®, Responsive Air®, Sleep Number Inner Circle®, Sleep30®, Smart Bed For Smart Kids®, Smart Bed Technology®, Tech-e®, 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™, RespiratoryIQ™, Sleep for the Future℠, Sleep Is Training™, This Is Not A Bed™ 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™, Comfortable. Adjustable. Affordable.™, CoolFit™, DualAir™, DualTemp™, Firmness Control™, FlexFit™, In Balance™, Partner Snore™, the SleepIQ LABS logo, The Bed Reborn™, The Bed That Moves You™, The Best Bed For Couples™ 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, including mattresses and foundations, is a mature and generally stable industry. According to the International Sleep Products Association (ISPA), the industry has grown by approximately 4% annually over the last 20 years and at an estimated 4% 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 and Company estimates, industry wholesale shipments of mattresses and foundations (excluding adjustable bases) were approximately $8.2 billion in 2018 compared to $8.4 billion in 2017. *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 2017, with an 8% 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 a 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 (approximately 200) 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 health, safety and environmental laws and regulations, including the federal fire retardant standards developed by the U.S. Consumer Product Safety Commission, which requires 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.

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 and privacy.

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 2019, 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 $450 million. The Credit Agreement contains an accordion feature that allows us to increase the amount of the credit facility from $450 million up to $600 million in total availability, subject to Lenders' approval. The Credit Agreement matures in February 2024.

Qualified customers are offered revolving credit to finance purchases through a private-label consumer credit facility provided by Synchrony Bank. Approximately 50% of our net sales in 2018 were financed by Synchrony Bank. Our current agreement with Synchrony Bank expires December 31, 2023, subject to earlier termination upon certain events. 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 29, 2018, we employed 4,220 individuals, including 2,167 retail sales and support team members, 382 customer service team members, 1,185 manufacturing and logistics team members, and 486 management and administrative team members, of which 59 were employed on a part-time or temporary basis. 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 regularly survey our team members with regard to engagement, and review engagement metrics and input with team members. We have a highly engaged team working in a values-driven culture, which we believe is important for an innovation company with an aspirational vision and life-changing mission.

Executive Officers of the Registrant

SHELLY R. IBACH, 59

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, 47

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, 49

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, 50

Senior Vice President and Chief Marketing Officer (Joined the Company in 2014)
Kevin K. Brown. Sleep Number® setting 40, serves as Senior vice President and Chief Marketing Officer and is responsible for building the Sleep Number brand through stories that set the Company apart, communicate Sleep Number's innovation and drive brand advocacy across all customer touchpoints. Before joining Sleep Number in 2014, Mr. Brown served in executive leadership roles at Meijer, Inc., Sears Holdings Corporation, Jo-Ann Stores, Inc. and Accenture.

DAVID R. CALLEN, 52

Chief Financial Officer (Joined the Company in 2014)
David R. Callen, Sleep Number® setting 50, serves as the Chief Financial Officer for Sleep Number. Prior to joining Sleep Number in April 2014, Mr. Callen served as the Principal Financial Officer for Ethan Allen Interiors, Inc., from 2007 to 2014. Mr. Callen has served for 30 years in several high-performing companies in increasingly responsible international financial management positions. His breadth of experience has emphasized business and financial strategy, brand support, and operational excellence across multiple industries including automotive, high-tech, dental, outdoor recreational products and public accounting.

ANDY P. CARLIN, 55

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 60, 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 February 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, 62

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

Patricia A. Dirks (Tricia), Sleep Number® setting 25, 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 Department Stores of Target Corporation.

SAMUEL R. HELLFELD, 40

Senior Vice President and Chief Legal and Risk Officer and Secretary (Joined the Company in 2013 and was promoted to current role in September 2018)

Samuel R. Hellfeld, Sleep Number® setting 65, serves as the Senior Vice President, Chief Legal and Risk Officer. From October 2015 to September 2018, Mr. Hellfeld served as Vice President, Associate General Counsel. Mr. Hellfeld joined Sleep Number in March 2013 as Corporate Counsel. Prior to joining Sleep Number, Mr. Hellfeld was a Partner in the law firm of Fox Rothschild LLP (fka Oppenheimer Wolff & Donnelly LLP) practicing in the areas of intellectual property and litigation. Prior to 2010, Mr. Hellfeld was an Associate at several law firms and also served as Law Clerk in the United States Court of Appeals for the Ninth Circuit and the United States District Court, Southern District of California.

SURESH KRISHNA, 50

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

Suresh Krishna, Sleep Number® setting 95, 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. In July 2014, he was promoted to Vice President and Business Unit Head of Europe Middle East & Africa (EMEA) for Polaris. From 2007 to 2010, he served as Vice President Global Operations, Supply Chain and IT at a division of UTC Fire & Security. Mr. Krishna also served in a variety of roles for Diageo, ABB and earlier in his career, he was an associate at Booz Allen & Hamilton.

J. HUNTER SAKLAD, 49

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 55, 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).

Our corporate 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, consumer shopping trends 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 depend 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, adjust 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 change 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 online 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) reviews of our products; (v) the nature and tone of consumer sentiment, including those published online or elsewhere; and (vi) 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 publication online or elsewhere of significant negative consumer sentiment regarding our Company, brand or our products, our sales, profitability, cash flows and financial condition may be adversely impacted.

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

The vast majority of our sales occur through our Company-Controlled distribution channels, including our retail stores and our website. These Company-Controlled distribution channels represent 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 579 retail stores in 50 U.S. states as of the end of 2018 and our website. 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. We may also 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 or regulatory actions 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 applicable to, or adequate for, liabilities actually incurred. A successful claim brought against us outside of, or 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 depend 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 bedding 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 depend 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 2018, we completed the transition to our new line of 360 smart bed mattresses to replace our prior line of mattresses. This new product roll-out required transition costs in our supply chain and retail stores. If we are not able to continue to innovate and gain widespread consumer acceptance of new products, 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. The emergence of these new competitors has significantly increased the costs of search terms and digital advertising.

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 our competitors 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, greater marketing resources, 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 profit 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*, *Sleep Number 360*, *360*, 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 adequate 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, advertising, 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 and 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, 2023, 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 which operate with minimal levels of inventory or due to global shortages of supply of electronic componentry or other materials, 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 and third parties that are, in some instances, the only source of supply or services 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 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 air chambers, blow-molded foundations, integrated non-adjustable foundations, adjustable foundations, various components for our Firmness Control systems, certain foam formulations, as well as our 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 third parties to deliver some of our products to our facilities and customers on a timely and cost-effective basis. These third-party providers could be vulnerable to labor shortages, liquidity concerns or other factors that may result in delays in deliveries or increased costs of deliveries. Any significant delay in deliveries to our customers could lead to increased returns and cause us to lose sales. Any increase in freight charges or other costs of deliveries could increase our costs of doing business and harm our sales, profitability, cash flows and financial condition.

Fluctuations in commodity prices or third-party logistics costs 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, as well as third-party logistic costs. Increases in prices of these commodities or logistics costs 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:

- Existing or potential duties, tariffs or quotas on certain types of goods that may be imported into the United States;
- Political instability resulting in disruption of trade;
- 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.

We cannot predict whether the countries in which some of our components are manufactured, or may be manufactured in the future, will be subject to new or additional trade restrictions imposed by the United States or other foreign governments, including the likelihood, type, or effect of any such restrictions. The United States government is contemplating various actions regarding trade with China, including the possibility of levying various tariffs on imports from China. As we source some of our components from China, any tariffs or other trade restrictions impacting the import of those components from China may have a material adverse impact on us.

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 or three assembly 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. We co-located two of the three currently operated assembly distribution centers at these sites with a third location in Baltimore, Maryland. 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 or three assembly 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 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 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 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 to our information systems. If our information 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 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.

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

Our information systems and information systems of third-party vendors we use to assist in the storage and management of information 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, including biometric data, from our customer base and social security numbers and demographic information of our employees. These information systems also contain confidential Company data regarding our business and innovations. While we maintain and require our third-party vendors to 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 data and 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 or our third-party vendors' systems and processes to adequately protect our data or 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 depend 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 579 retail stores as of December 29, 2018:

	Retail Stores		Retail Stores		Retail Stores
Alabama	10	Louisiana	8	Ohio	21
Alaska	1	Maine	2	Oklahoma	5
Arizona	10	Maryland	14	Oregon	7
Arkansas	4	Massachusetts	11	Pennsylvania	21
California	66	Michigan	18	Rhode Island	1
Colorado	14	Minnesota	16	South Carolina	8
Connecticut	6	Mississippi	5	South Dakota	2
Delaware	2	Missouri	12	Tennessee	11
Florida	41	Montana	4	Texas	53
Georgia	20	Nebraska	4	Utah	6
Hawaii	1	Nevada	5	Vermont	1
Idaho	8	New Hampshire	4	Virginia	18
Illinois	3	New Jersey	16	Washington	14
Indiana	21	New Mexico	3	West Virginia	2
Iowa	11	New York	20	Wisconsin	12
Kansas	8	North Carolina	16	Wyoming	1
Kentucky	8	North Dakota	4	Total	579

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, assembly 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 16,000 square feet. This lease runs through February 2029 and contains two five-year renewal options.

We lease one facility for assembly and distribution of products in Baltimore, Maryland containing approximately 89,000 square feet. This lease runs through October 2025 and contains two three-year renewal options.

We lease approximately 900 square feet of office space in Portland, Oregon. This lease 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. If a loss is reasonably possible but not known or probable, and may be reasonably estimated, the estimated loss or range of loss is disclosed. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible 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 pending legal proceedings to have a material effect on our consolidated results of operations, financial position or cash flows. Litigation, however, is inherently unpredictable, and it is possible that the ultimate outcome of one or more claims asserted against us could adversely impact our consolidated results of operations, financial position or cash flows. We expense legal costs as incurred.

On 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 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 accepted the certified questions and on April 16, 2018, ruled in our favor on one of the two questions, holding that a consumer only has standing to bring a claim under the relevant statute if the consumer has been harmed by the defendant's conduct. The Third Circuit remanded the case to the federal district court, which initially allowed the plaintiffs to file its proposed amended complaint, but thereafter rescinded its order and then denied Plaintiffs' request to file the amended complaint. We plan to ask the Court to dismiss the case.

On September 18, 2018, former Home Delivery Technician, Donald Cassels, and former Field Services Delivery Assistant, Jose Cadenas, filed suit in Superior Court in San Francisco County, California alleging representative claims on a purported class action basis under the California Labor Code Private Attorney General Act. While the two representative plaintiffs were in the Home Delivery workforce, the Complaint does not limit the purported plaintiff class to that group. The plaintiffs allege that Sleep Number failed or refused to adopt adequate practices, policies and procedures relating to wage payments, record keeping, employment disclosures, meal and rest breaks, among other claims, under California law. The plaintiffs purport to represent all former and current Sleep Number employees in the State of California aggrieved by the alleged practices. The Complaint seeks damages in the form of civil penalties and plaintiffs' attorneys' fees, and expressly disclaims the recovery of any purported individual specific relief or underpaid wages. After Sleep Number raised issues with the plaintiffs' choice of venue, the Court transferred venue from the Superior Court in San Francisco County to Superior Court in Fresno County. We intend to vigorously defend this matter.

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, 2019, there were approximately 215 holders of record of our common stock.

We are not restricted from paying cash dividends under our credit agreement so long as we are not in default under the credit agreement*,* our leverage ratio (as defined in our credit agreement) after giving effect to such restricted payments (as defined in our credit agreement) would not exceed 3.75:1.00 and no default or event of default (as defined in our credit agreement) would result therefrom. 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 2018 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)]
September 30, 2018 through October 27, 2018	614,828	$ 33.96	612,303	$ 249,204,000
October 28, 2018 through November 24, 2018	538,300	$ 37.97	537,913	228,779,000
November 25, 2018 through December 29, 2018	1,233,468	$ 34.77	1,233,378	185,899,000
Total	2,386,596		2,383,594	$ 185,899,000

(1) Under our Board-approved $500 million share repurchase program, we repurchased 2,383,594 shares of our common stock at a cost of $84 million (based on trade dates) during the three months ended December 29, 2018.

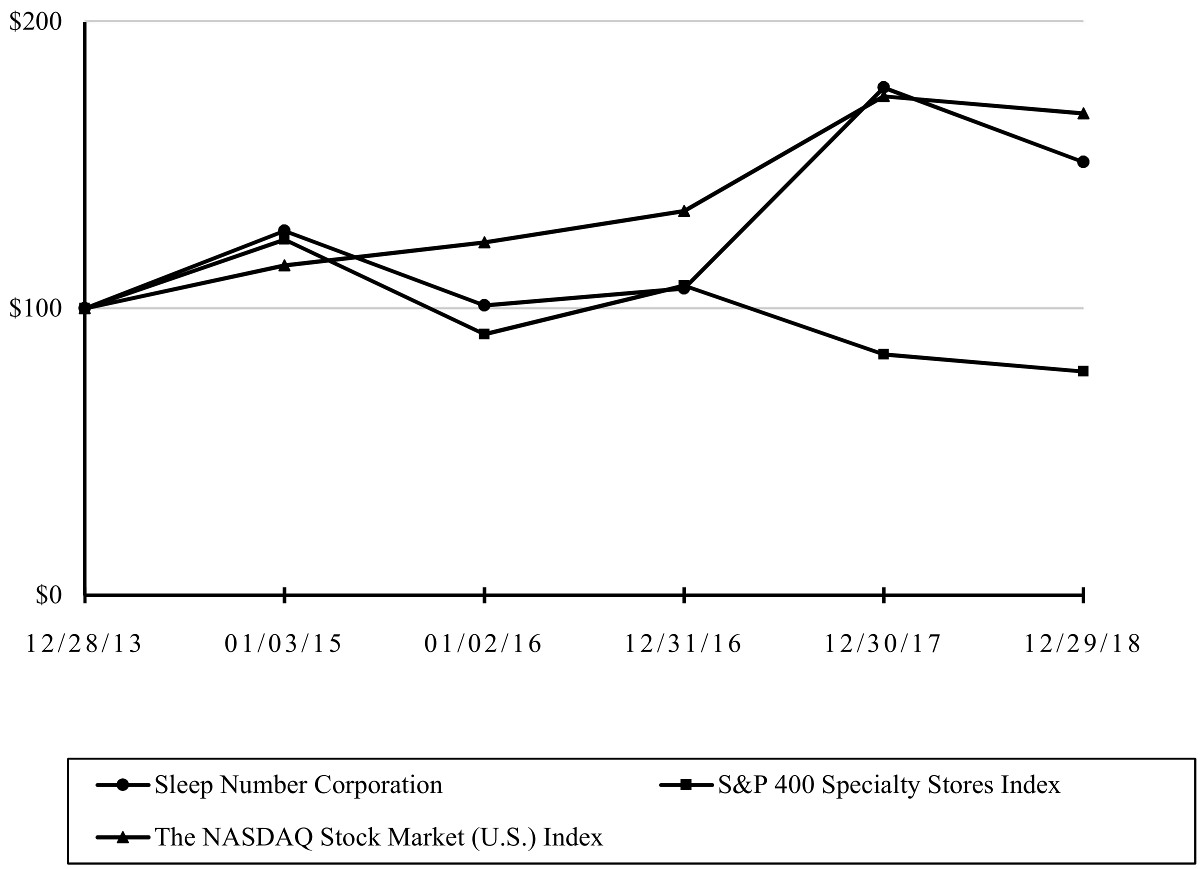
(2) In connection with the vesting of employee restricted stock grants, we also repurchased 3,002 shares of our common stock at a cost of $104 thousand during the three months ended December 29, 2018.

(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 28, 2013. 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



	12/28/13	01/03/15	01/02/16	12/31/16	12/30/17	12/29/18
Sleep Number Corporation	$ 100	$ 127	$ 101	$ 107	$ 177	$ 151
S&P 400 Specialty Stores Index	100	124	91	108	84	78
The NASDAQ Stock Market (U.S.) Index	100	115	123	134	174	168

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				
	2018	**2017**	**2016**	**2015**	**2014[1]**
Consolidated Statements of Operations Data:					
Net sales	$1,531,575	$1,444,497	$1,311,291	$1,213,699	$1,156,757
Gross profit	927,961	897,347	810,160	740,751	706,850
Operating expenses:					
Sales and marketing	687,380	650,357	595,845	550,475	512,007
General and administrative	119,378	127,269	109,674	99,209	84,864
Research and development	28,775	27,806	27,991	15,971	8,233
Operating income	92,428	91,915	76,650	75,096	101,746
Net income	$ 69,539	$ 65,077	$ 51,417	$ 50,519	$ 67,974
Net income per share:					
Basic	$ 1.97	$ 1.58	$ 1.11	$ 0.99	$ 1.27
Diluted	$ 1.92	$ 1.55	$ 1.10	$ 0.97	$ 1.25
Shares used in calculation of net income per share:					
Basic	35,256	41,212	46,154	51,252	53,452
Diluted	36,165	42,085	46,902	52,101	54,193
Consolidated Balance Sheet Data:					
Cash, cash equivalents and marketable debt securities	$ 1,612	$ 3,651	$ 11,609	$ 36,114	$ 166,045
Total assets	470,138	471,834	457,166	500,897	474,187
Total shareholders' (deficit) equity	(109,550)	89,156	160,320	222,339	256,907
Selected Operating Data:					
Stores open at period-end	579	556	540	488	463
Stores opened during period	53	36	72	38	57
Stores closed during period	30	20	20	13	34
Average sales per store (000's)[2]	$ 2,707	$ 2,618	$ 2,555	$ 2,536	$ 2,512
Percentage of stores with more than $1.0 million in net sales[3]	98%	98%	98%	99%	98%
Percentage of stores with more than $2.0 million in net sales[3]	65%	61%	61%	62%	59%
Average revenue per mattress unit - Company-Controlled channel[4]	$ 4,482	$ 4,283	$ 4,046	$ 4,028	$ 3,671
Company-Controlled comparable-sales increase[5]	3%	4%	1%	3%	12%
Total retail square footage (at period-end) (000's)	1,598	1,489	1,399	1,214	1,106
Average square footage per store open during period[3]	2,725	2,647	2,538	2,445	2,302
Average sales per square foot[2]	$ 998	$ 995	$ 1,013	$ 1,045	$ 1,107
Average store age (in months at period-end)	95	97	93	99	97
Earnings before interest, depreciation and amortization (Adjusted EBITDA)[6]	$ 165,588	$ 169,097	$ 145,689	$ 133,057	$ 148,223
Free cash flows[6]	$ 86,025	$ 112,778	$ 93,793	$ 22,356	$ 67,874
Return on invested capital (ROIC)[6]	16.0%	14.3%	12.2%	11.2%	15.1%

(1) Fiscal year 2014 had 53 weeks. All other fiscal years presented had 52 weeks.
(2) Trailing-twelve months Company-Controlled comparable sales per store open at least one year.
(3) For stores open during the entire period indicated (excludes online and phone sales).
(4) Represents Company-Controlled channel total net sales divided by Company-Controlled channel mattress units.
(5) 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 524, 512, 459, 442 and 396 for 2018, 2017, 2016, 2015 and 2014, 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.
(6) 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				
	2018	**2017**	**2016**	**2015**	**2014**
Net income	$ 69,539	$ 65,077	$ 51,417	$ 50,519	$ 67,974
Income tax expense	16,982	25,961	24,516	24,911	34,134
Interest expense	5,911	975	811	160	53
Depreciation and amortization	61,648	61,077	56,910	46,916	38,767
Stock-based compensation	11,412	15,763	11,961	10,290	6,798
Asset impairments	96	244	74	261	497
Adjusted EBITDA	$ 165,588	$ 169,097	$ 145,689	$ 133,057	$ 148,223

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				
	2018	**2017**	**2016**	**2015**	**2014**
Net cash provided by operating activities	$ 131,540	$ 172,607	$ 151,645	$ 107,942	$ 144,468
Less: Purchases of property and equipment	(45,515)	(59,829)	(57,852)	(85,586)	(76,594)
Free cash flow	$ 86,025	$ 112,778	$ 93,793	$ 22,356	$ 67,874

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				
	2018	**2017**	**2016**	**2015**	**2014**
Net operating profit after taxes (NOPAT)					
Operating income	$ 92,428	$ 91,915	$ 76,650	$ 75,096	$ 101,746
Add: Rent expense[1]	79,390	74,019	67,416	62,369	57,605
Add: Interest income	4	97	94	494	415
Less: Depreciation on capitalized operating leases[2]	(20,392)	(18,865)	(17,185)	(16,203)	(14,265)
Less: Income taxes[3]	(36,444)	(48,970)	(41,933)	(40,384)	(48,900)
NOPAT	$ 114,986	$ 98,196	$ 85,042	$ 81,372	$ 96,601
Average invested capital					
Total (deficit) equity	$ (109,550)	$ 89,156	$ 160,320	$ 222,339	$ 256,907
Less: Cash greater than target [4]	—	—	—	—	(37,319)
Add: Long-term debt[5]	200,458	—	—	—	—
Add: Capitalized operating lease obligations[6]	635,120	592,152	539,328	498,952	460,840
Total invested capital at end of period	$ 726,028	$ 681,308	$ 699,648	$ 721,291	$ 680,428
Average invested capital[7]	$ 719,055	$ 686,436	$ 699,576	$ 726,756	$ 639,118
Return on invested capital (ROIC)[8]	16.0%	14.3%	12.2%	11.2%	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 24.1%, 33.3%, 33.0%, 33.2% and 33.6% for 2018, 2017, 2016, 2015 and 2014, 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. Our revolving credit facility's leverage covenant computation is based on a multiple of six times annual rent expense.

(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, advertising, or trademarks infringe the intellectual property rights of others;*
- *Availability of attractive and cost-effective consumer credit options;*
- *Our manufacturing processes with minimal levels of inventory, which may leave us vulnerable to shortages in supply;*
- *Our dependence on significant suppliers and third parties and our ability to maintain relationships with key suppliers or third-parties, including several sole-source suppliers or providers of services;*
- *Rising commodity costs and other inflationary pressures;*
- *Risks inherent in global sourcing activities, including tariffs and the potential for shortages in supply;*
- *Risks of disruption in the operation of either of our three main manufacturing facilities or three assembly facilities;*
- *Increasing government regulation;*
- *Pending or unforeseen litigation and the potential for adverse publicity associated with litigation;*
- *The adequacy of our and third-party information systems to meet the evolving needs of our business and existing and evolving risks and regulatory standards applicable to data privacy and security;*
- *The costs and potential disruptions to our business related to upgrading our information systems;*
- *The vulnerability of our and third-party information systems to attacks by hackers or other cyber threats that could compromise the security of our systems, result in a data breach or disrupt our business*
- *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

Sleep Number is the exclusive designer, manufacturer, marketer, retailer and servicer of Sleep Number beds and the leader in sleep innovation. We offer our customers high-quality, individualized sleep solutions and services, including a complete line of Sleep Number beds, bases and bedding accessories. We are also the pioneer and leader in biometric sleep innovation and tracking. Our proprietary SleepIQ technology, the operating system of the 360 smart bed, works with our proprietary algorithms and artificial intelligence to track user's sleep patterns and biometric changes. SleepIQ allows each bed to use the sleeper's own data to automatically and effortlessly adjust the bed's firmness, delivering proven quality sleep.

Our relentless focus on developing winning innovation for our customers is also helping us to deliver superior shareholder value, by: (i) increasing consumer demand; (ii) leveraging our business model; and (iii) deploying capital efficiently.

Results of Operations

Fiscal 2018 Summary

Financial highlights for fiscal 2018 were as follows:

- Net sales for 2018 increased 6% to $1.53 billion, compared with $1.44 billion in 2017. Company-Controlled comparable sales increased 3% and sales from 23 net new stores opened in the past 12 months added 3 percentage points (ppt.) of growth in 2018.
- Net sales accelerated in the back-half of 2018 after we transitioned to selling all Sleep Number 360 smart beds. In January 2017 at CES, Sleep Number introduced the Sleep Number 360 smart bed line, the most significant innovation in our 30-year history. In May 2017, we began selling our i7 and i10 smart beds. We launched a third smart bed model (the p6) in December 2017. In April 2018, we introduced the Sleep Number 360 p5 and i8 smart beds, our two most popular models. Our c4 and c2 bed models completed the transition in June and July 2018, respectively. The Sleep Number 360 smart bed won 13 awards at CES 2017, including being named the Best of Innovation Honoree in the Home Appliance category. It also received the 2018 Edison Silver Award for breakthrough product design and innovation in the Wellness Technology category. Sleep Number was ranked #1 in Customer Satisfaction with Mattresses by J.D. Power in 2018 and the best in six out of seven categories (support, durability, comfort, features, value and warranty).
- On a trailing twelve-month basis, 2018 net sales per store (for stores open at least one year, including online and phone sales) of $2.7 million increased 3% from $2.6 million in 2017.
- 2018 operating income of $92 million increased 1% compared with the prior year despite significant gross margin costs associated with transitioning to all 360 smart beds, including excess freight, storage, product handling, operating inefficiencies and close-out sales of our prior line of beds. Our 2018 operating income rate decreased to 6.0% of net sales, compared with 6.4% of net sales in 2017. The increase in operating income was attributable to: (i) the 6% increase in net sales; (ii) the operating expense leverage resulting from the 6% increase in net sales and reduced corporate incentive compensation; partially offset by (iii) a 1.5 ppt. decrease in our gross profit rate primarily due to the product transition costs noted above.
- Net income in 2018 increased 7% to $70 million compared with net income of $65 million in 2017. Net income per diluted share increased 24% to $1.92 versus $1.55 per diluted share in 2017. Net income per diluted share in 2018 benefited from a lower income tax rate (Tax Cuts and Jobs Act) and a reduction in diluted average shares outstanding (share repurchases).
- We achieved a return on invested capital (ROIC) of 16.0% in 2018, compared with our high-single digit weighted average cost of capital.
- Cash provided by operating activities in 2018 decreased to $132 million, compared with $173 million for the prior year. Purchases of property and equipment for 2018 decreased to $46 million, compared with $60 million in 2017.
- We ended 2018 with $200 million of borrowings under our revolving credit facility (as planned), compared with $25 million at the end of 2017. We utilize our credit facility for general corporate purposes, to meet our seasonal working capital requirements and to repurchase our stock. In February 2019, we amended our revolving credit facility to increase our net aggregate availability to $450 million.
- In 2018, we repurchased 8.3 million shares of our common stock at a cost of $279 million ($33.60 per share, based on trade date) under our Board-approved share repurchase program. As of December 29, 2018, the remaining authorization under our Board-approved share repurchase program was $186 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.

	2018		2017		2016	
	$	**% of Net Sales**	**$**	**% of Net Sales**	**$**	**% of Net Sales**
Net sales	$ 1,531.6	100.0%	$ 1,444.5	100.0%	$ 1,311.3	100.0%
Cost of sales	603.6	39.4	547.2	37.9	501.1	38.2
Gross profit	928.0	60.6	897.3	62.1	810.2	61.8
Operating expenses:						
Sales and marketing	687.4	44.9	650.4	45.0	595.8	45.4
General and administrative	119.4	7.8	127.3	8.8	109.7	8.4
Research and development	28.8	1.9	27.8	1.9	28.0	2.1
Total operating expenses	835.5	54.6	805.4	55.8	733.5	55.9
Operating income	92.4	6.0	91.9	6.4	76.7	5.8
Other expense, net	5.9	0.4	0.9	0.1	0.7	0.1
Income before income taxes	86.5	5.6	91.0	6.3	75.9	5.8
Income tax expense	17.0	1.1	26.0	1.8	24.5	1.9
Net income	$ 69.5	4.5%	$ 65.1	4.5%	$ 51.4	3.9%
Net income per share:						
Basic	$ 1.97		$ 1.58		$ 1.11	
Diluted	$ 1.92		$ 1.55		$ 1.10	
Weighted-average number of common shares:						
Basic	35.3		41.2		46.2	
Diluted	36.2		42.1		46.9	

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

	2018	2017	2016
Company-Controlled channel	99.1%	98.7%	97.7%
Wholesale/Other channel	0.9%	1.3%	2.3%
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)		
	2018	2017	2016
Retail comparable-store sales[(1)]	3%	3%	0%
Online and phone[(1)]	15%	16%	25%
Company-Controlled comparable sales change[(1)]	3%	4%	1%
Net opened/closed stores	3%	7%	7%
Total Company-Controlled channel	6%	11%	8%
Wholesale/Other channel	(26%)	(38%)	5%
Total net sales change	6%	10%	8%

(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:

	2018	2017	2016
Average sales per store[(1)] ($ in thousands)	$ 2,707	$ 2,618	$ 2,555
Average sales per square foot[(1)]	$ 998	$ 995	$ 1,013
Stores > $1 million in net sales[(2)]	98%	98%	98%
Stores > $2 million in net sales[(2)]	65%	61%	61%
Average revenue per mattress unit – Company-Controlled channel[(3)]	$ 4,482	$ 4,283	$ 4,046

(1) Trailing-twelve months Company-Controlled comparable sales per store open at least one year.
(2) Trailing-twelve months for stores open at least one year (excludes online and phone sales).
(3) Represents 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:

	2018	2017	2016
Beginning of period	556	540	488
Opened	53	36	72
Closed	(30)	(20)	(20)
End of period	579	556	540

Comparison of 2018 and 2017

Net sales

Net sales in 2018 increased 6% to $1.53 billion, compared with $1.44 billion in 2017. The sales increase was driven by a 3% comparable sales increase in our Company-Controlled channel and 3 percentage points (ppt.) of growth from sales generated by 23 net new retail stores opened in the past 12 months, partially offset by a decrease in Wholesale/Other channel sales.

The $87 million net sales increase compared with the same period one year ago was primarily comprised of: (i) a $47 million increase from Company-Controlled comparable sales; and (ii) a $45 million increase resulting from net store openings; partially offset by (iii) a $5 million decrease in Wholesale/Other channel sales. Company-Controlled mattress units increased 2% compared to the prior-year period. Average revenue per mattress unit in our Company-Controlled channel increased by 5%.

Net sales accelerated in the back-half of 2018 after we transitioned to selling all Sleep Number 360 smart beds. In January 2017 at CES, Sleep Number introduced the Sleep Number 360 smart bed line, the most significant innovation in our 30-year history. In May 2017, we began selling our i7 and i10 smart beds. We launched a third smart bed model (the p6) in December 2017. In April 2018, we introduced the Sleep Number 360 p5 and i8 smart beds, our two most popular models. Our c4 and c2 bed models completed the transition in June and July 2018, respectively. The Sleep Number 360 smart bed won 13 awards at CES 2017, including being named the Best of Innovation Honoree in the Home Appliance category. It also received the 2018 Edison Silver Award for breakthrough product design and innovation in the Wellness Technology category. Sleep Number was ranked #1 in Customer Satisfaction with Mattresses by J.D. Power in 2018 and the best in six out of seven categories (support, durability, comfort, features, value and warranty).

Gross profit

Gross profit for 2018 of $928 million increased by $31 million, or 3% compared with $897 million in 2017. The 2018 gross profit rate decreased to 60.6% of net sales, compared with 62.1% for the prior-year period. The 1.5 ppt. decrease in the gross profit rate was primarily due to: (i) significant costs associated with transitioning to all 360 smart beds, including excess freight, storage and product handling; (ii) inefficiencies related to operating two product lines for most of 2018; (iii) close-out sales of our prior line of beds; and (iv) a higher mix of lower-margin products, including our FlexFit adjustable bases. In addition, our gross profit rate can fluctuate from year to year due to a variety of other factors, including warranty expenses, sales return and exchange costs, and performance-based incentive compensation.

Sales and marketing expenses

Sales and marketing expenses in 2018 increased $37 million to $687 million, compared with $650 million last year. The sales and marketing expense rate decreased slightly to 44.9% of net sales compared with 45.0% for the same period one year ago due to: (i) the expense leverage from the 6% increase in net sales; partially offset by (ii) an increase in media and promotional expenses that drove additional customer traffic to our sales channels, including stores, online and phone.

General and administrative expenses

General and administrative (G&A) expenses decreased $8 million to $119 million in 2018, compared with $127 million in the prior year and decreased to 7.8% of net sales, compared with 8.8% of net sales one year ago. The $8 million decrease in G&A expenses consisted of the following major components: (i) a $7.0 million reduction in employee compensation resulting from a year-over-year decrease in Company-wide performance-based incentive compensation; and (ii) $1.0 million decrease in miscellaneous other expenses. The G&A expense rate decreased by 1.0 ppt. in 2018 compared with the same period one year ago due to the decrease in expenses discussed above and the leveraging impact of the 6% net sales increase.

Other expense, net

Other expense, net increased to $6 million for the year ended December 29, 2018 compared with $1 million for the same period one year ago. The increase was driven by increased interest expense from a higher average debt balance on our revolving line of credit and an increase in the weighted-average interest rate on borrowings outstanding.

Income tax expense

Income tax expense was $17 million for the year ended December 29, 2018, compared with $26 million for the same period one year ago. The effective tax rate for the year ended December 29, 2018 decreased to 19.6% compared with 28.5% for 2017 reflecting the changes associated with the “Tax Cuts and Jobs Act” (TCJA), including a reduction in the federal income tax rate to 21% from 35%. Tax expense for 2017 included a $1.7 million provisional tax benefit from revaluing deferred taxes in accordance with the TCJA. Tax expense for 2018 included a $2.9 million increase in the 2017 provisional tax benefit based on new information, including a tax planning analysis. Both periods' tax expense and effective tax rates included stock-based compensation excess tax benefits. See Note 12, *Income Taxes*, for further information.

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.

Liquidity and Capital Resources

Managing our liquidity and capital resources is an important part of our commitment to deliver superior shareholder value. Our primary sources of liquidity are cash flows provided by operating activities and cash available under our $450 million revolving credit facility (increased in February 2019 from $300 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 29, 2018, cash and cash equivalents totaled $2 million compared with $4 million as of December 30, 2017. The main components of the $2 million change in cash and cash equivalents were $132 million of cash provided by operating activities and $182 million increase in short-term borrowings, which were more than offset by $46 million of cash used to purchase property and equipment and $272 million of cash used to repurchase our common stock (based on settlement, we repurchased $282 million based on trade date).

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

	2018	2017
Total cash provided by (used in):		
Operating activities	$ 131.5	$ 172.6
Investing activities	(45.2)	(59.8)
Financing activities	(88.3)	(123.9)
Net decrease in cash and cash equivalents	$ (2.0)	$ (11.1)

Cash provided by operating activities for the fiscal year ended December 29, 2018 was $132 million compared with $173 million for the fiscal year ended December 30, 2017. Significant components of the $41 million year-over-year change in cash from operating activities included: (i) a $4 million increase in net income in 2018 compared with 2017; (ii) a $32 million fluctuation in accounts payable with both years impacted by business changes and timing of payments; (iii)) a $22 million fluctuation in the amount accrued and timing of compensation and benefits payments due to year-over-year changes in Company-wide performance-based incentive compensation; and (iv) an $18 million fluctuation in prepaid expenses and other assets with both years impacted by timing of rent payments and changes in business activities.

Net cash used in investing activities was $45 million for the fiscal year ended December 29, 2018, compared with $60 million for the same period one year ago. Investing activities for the current-year period included $46 million of property and equipment purchases, compared with $60 million for the same period last year.

Net cash used in financing activities was $88 million for the fiscal year ended December 29, 2018, compared with net cash used in financing activities of $124 million for the same period one year ago. During the fiscal year ended December 29, 2018, we repurchased $272 million of our common stock (based on settlement, $269 million under our Board-approved share repurchase program and $3 million in connection with the vesting of employee restricted stock grants) compared with $155 million during the same period one year ago. Short-term borrowings fluctuated by $154 million compared with the prior-year period, reflecting $200 million of borrowings under our revolving credit facility as of December 29, 2018, compared with $25 million as of December 30, 2017. 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 8.3 million shares at a cost of $279 million (based on trade date, $33.60 per share) during the fiscal year ended December 29, 2018. During 2017, we repurchased 5.4 million shares at a cost of $150 million ($28.00 per share). As of December 29, 2018, the remaining authorization under our Board-approved share repurchase program was $186 million. There is no expiration date governing the period over which we can repurchase shares.

In February 2019, 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 $450 million. The Credit Agreement contains an accordion feature that allows us to increase the amount of the credit facility from $450 million up to $600 million in total availability, subject to Lenders' approval. The Credit Agreement matures in February 2024.

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 29, 2018, we had $200 million in outstanding borrowings and $3 million in outstanding letters of credit. As of December 29, 2018, the weighted-average interest rate on borrowings outstanding under the credit facility was 4.2%, and we were in compliance with all financial covenants.

We have an agreement with Synchrony Bank to offer qualified customers revolving credit arrangements to finance purchases from us (Synchrony Agreement). The Synchrony Agreement contains certain financial covenants, including a maximum leverage ratio and a minimum interest coverage ratio. As of December 29, 2018, 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 29, 2018, we were not involved in any unconsolidated special purpose entity transactions. Other than our operating leases and $3 million in outstanding letters 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 6, *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 29, 2018 (in thousands):

	Payments Due by Period[1]				
	Total	< 1 Year	1 - 3 Years	3 - 5 Years	> 5 Years
Operating leases[2]	$ 478,068	$ 78,337	$ 139,822	$ 110,591	$ 149,318
Capital leases	1,023	139	278	258	348
Purchase commitments	31,923	31,923	—	—	—
Total	$ 511,014	$ 110,399	$ 140,100	$ 110,849	$ 149,666

(1) Our unrecognized tax benefits, including interest and penalties, of $4 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 46 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 $62 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 8, *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 29, 2018, would have affected net income by approximately $0.9 million in 2018.
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 5, *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 2018, 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 29, 2018, would have affected net income by approximately $0.8 million in 2018.
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*, and Note 9, *Revenue Recognition*, 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 29, 2018 would have affected net income by approximately $1.5 million in 2018.

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 annual net income would decrease by $1.5 million based on the $200 million of borrowings under our revolving credit facility at December 29, 2018. 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

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 29, 2018 and December 30, 2017, the related consolidated statements of income, comprehensive income, shareholders’ equity, and cash flows for each of the three years in the period ended December 29, 2018, 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 29, 2018 and December 30, 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 29, 2018, 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 29, 2018, 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 26, 2019, 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, MN
February 26, 2019

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

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 29, 2018, 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 29, 2018, 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 29, 2018, of the Company and our report dated February 26, 2019 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 26, 2019

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Balance Sheets
December 29, 2018 and December 30, 2017
(in thousands, except per share amounts)

	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	$ 1,612	$ 3,651
Accounts receivable, net of allowance for doubtful accounts of $699 and $714, respectively	24,795	19,312
Inventories	84,882	84,298
Prepaid expenses	8,009	17,565
Other current assets	31,559	27,665
Total current assets	150,857	152,491
Non-current assets:		
Property and equipment, net	205,631	208,646
Goodwill and intangible assets, net	75,407	77,588
Deferred income taxes	—	2,625
Other non-current assets	38,243	30,484
Total assets	$ 470,138	$ 471,834
Liabilities and Shareholders' (Deficit) Equity		
Current liabilities:		
Borrowings under revolving credit facility	$ 199,600	$ 24,500
Accounts payable	144,781	129,194
Customer prepayments	27,066	27,767
Accrued sales returns	19,907	19,270
Compensation and benefits	27,700	34,602
Taxes and withholding	18,380	24,234
Other current liabilities	51,234	46,822
Total current liabilities	488,668	306,389
Non-current liabilities:		
Deferred income taxes	4,822	—
Other non-current liabilities	86,198	76,289
Total liabilities	579,688	382,678
Shareholders' (deficit) equity:		
Undesignated preferred stock; 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, $0.01 par value; 142,500 shares authorized, 30,868 and 38,813 shares issued and outstanding, respectively	309	388
Additional paid-in capital	—	—
(Accumulated deficit) retained earnings	(109,859)	88,768
Total shareholders' (deficit) equity	(109,550)	89,156
Total liabilities and shareholders' (deficit) equity	$ 470,138	$ 471,834

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Operations
Years ended December 29, 2018, December 30, 2017 and December 31, 2016
(in thousands, except per share amounts)

	2018	2017	2016
Net sales	$ 1,531,575	$ 1,444,497	$ 1,311,291
Cost of sales	603,614	547,150	501,131
Gross profit	927,961	897,347	810,160
Operating expenses:			
Sales and marketing	687,380	650,357	595,845
General and administrative	119,378	127,269	109,674
Research and development	28,775	27,806	27,991
Total operating expenses	835,533	805,432	733,510
Operating income	92,428	91,915	76,650
Other expense, net	5,907	877	717
Income before income taxes	86,521	91,038	75,933
Income tax expense	16,982	25,961	24,516
Net income	$ 69,539	$ 65,077	$ 51,417
Basic net income per share:			
Net income per share – basic	$ 1.97	$ 1.58	$ 1.11
Weighted-average shares – basic	35,256	41,212	46,154
Diluted net income per share:			
Net income per share – diluted	$ 1.92	$ 1.55	$ 1.10
Weighted-average shares – diluted	36,165	42,085	46,902

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income
Years ended December 29, 2018, December 30, 2017 and December 31, 2016
(in thousands)

	2018	2017	2016
Net income	$ 69,539	$ 65,077	$ 51,417
Other comprehensive income – unrealized gain on available-for-sale marketable debt securities, net of income tax	—	—	14
Comprehensive income	$ 69,539	$ 65,077	$ 51,431

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Shareholders' (Deficit) Equity
Years ended December 29, 2018, December 30, 2017 and December 31, 2016
(in thousands)

	Common Stock		Additional Paid-in	Retained Earnings (Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Deficit)	Income/(Loss)	Total
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
Net income	—	—	—	69,539	—	69,539
Exercise of common stock options	186	2	2,786	—	—	2,788
Stock-based compensation	271	3	11,409	—	—	11,412
Repurchases of common stock	(8,402)	(84)	(14,195)	(268,166)	—	(282,445)
Balance at December 29, 2018	30,868	$ 309	$ —	$ (109,859)	$ —	$ (109,550)

See accompanying notes to consolidated financial statements.

SLEEP NUMBER CORPORATION
AND SUBSIDIARIES

Consolidated Statements of Cash Flows
Years ended December 29, 2018, December 30, 2017 and December 31, 2016
(in thousands)

	2018	2017	2016
Cash flows from operating activities:			
Net income	$ 69,539	$ 65,077	$ 51,417
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	61,966	61,291	57,172
Stock-based compensation	11,412	15,763	11,961
Net (gain) loss on disposals and impairments of assets	(51)	249	27
Excess tax benefits from stock-based compensation	—	—	(517)
Deferred income taxes	7,447	2,042	(1,640)
Changes in operating assets and liabilities:			
Accounts receivable	(5,483)	393	9,297
Inventories	(584)	(9,272)	11,574
Income taxes	(6,561)	1,697	25,119
Prepaid expenses and other assets	5,551	(12,405)	(2,195)
Accounts payable	(9,894)	21,779	(4,965)
Customer prepayments	(701)	1,560	(25,266)
Accrued compensation and benefits	(6,872)	15,398	2,808
Other taxes and withholding	707	(893)	2,723
Other accruals and liabilities	5,064	9,928	14,130
Net cash provided by operating activities	131,540	172,607	151,645
Cash flows from investing activities:			
Purchases of property and equipment	(45,515)	(59,829)	(57,852)
Proceeds from sales of property and equipment	272	36	92
Proceeds from marketable debt securities	—	—	21,053
Investments in marketable debt securities	—	—	(5,968)
Net cash used in investing activities	(45,243)	(59,793)	(42,675)
Cash flows from financing activities:			
Repurchases of common stock	(272,446)	(155,245)	(126,693)
Net increase in short-term borrowings	182,336	28,094	5,932
Proceeds from issuance of common stock	2,788	3,241	2,298
Debt issuance costs	(1,014)	(12)	(409)
Excess tax benefits from stock-based compensation	—	—	517
Net cash used in financing activities	(88,336)	(123,922)	(118,355)
Net decrease in cash, cash equivalents and restricted cash	(2,039)	(11,108)	(9,385)
Cash, cash equivalents and restricted cash, at beginning of period	3,651	14,759	24,144
Cash, cash equivalents and restricted cash, at end of period	$ 1,612	$ 3,651	$ 14,759
Non-cash financing transactions:			
Change in unsettled repurchases of common stock	$ 9,999	$ —	$ —
Supplemental Disclosure of Cash Flow Information			
Income taxes paid (received)	$ 15,031	$ 22,807	$ (653)
Interest paid	$ 5,086	$ 753	$ 608
Capital lease obligations incurred	$ 943	$ —	$ —
Purchases of property and equipment included in accounts payable	$ 12,123	$ 3,964	$ 5,517

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 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 which allows us to offer consumers high-quality, individualized sleep solutions and services. 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 by 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 2018 ended December 29, 2018; fiscal 2017 ended December 30, 2017; and fiscal 2016 ended December 31, 2016. Fiscal years 2018, 2017 and 2016 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 $38 million and $30 million at December 29, 2018 and December 30, 2017, respectively.

Accounts Receivable

Accounts receivable are recorded net of an allowance for expected losses and consist primarily of receivables from third-party financiers for customer credit card purchases and receivables from wholesale customers. 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. We review inventory quantities on hand and record reserves for obsolescence based on historical selling prices, current market conditions and forecasted product demand, to reduce inventory to net realizable value.

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	3 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 and trade names/trademarks. Definite-lived intangible assets are being amortized using the straight-line method over their estimated lives, ranging from 8-10 years.

Asset Impairment Charges

Long-lived Assets and Definite-lived Intangible Assets - 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.

Goodwill and Indefinite-lived Intangible Assets - 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 2018 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. The majority of our warranty claims are incurred within the first year. Our warranty liability contains uncertainties because our warranty obligations cover an extended period of time and require management to make estimates for claim rates and the projected cost of materials and freight associated with sending replacement parts to customers. 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):

	2018	2017	2016
Balance at beginning of period	$ 9,320	$ 8,633	$ 10,028
Additions charged to costs and expenses for current-year sales	12,385	12,214	9,034
Deductions from reserves	(11,743)	(10,752)	(10,016)
Changes in liability for pre-existing warranties during the current year, including expirations	427	(775)	(413)
Balance at end of period	$ 10,389	$ 9,320	$ 8,633

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, our leverage ratio (as defined in our credit agreement) after giving effect to such restricted payments (as defined in our credit agreement) would not exceed 3.75:1.00 and no default or event of default (as defined in our credit agreement) would result therefrom. However, we have not historically paid, and have no current plans to pay, cash dividends on our common stock.

Revenue Recognition

We recognize revenue when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services. Revenue recognized excludes sales taxes. Amounts billed to customers for delivery and setup are included in net sales. For most products, we receive payment before or promptly after, the products or services are delivered to the customer.

Our beds sold with SleepIQ technology contain multiple performance obligations including the bed and SleepIQ hardware and software. We analyze our multiple performance obligation(s) to determine whether they are distinct and can be separated or whether they must be accounted for as a single performance obligation. We determined that the beds sold with the SleepIQ technology have two performance obligations consisting of: (i) the bed; and (ii) SleepIQ hardware and software. SleepIQ 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 determine the transaction price for multiple performance obligations based on their relative standalone selling prices. The performance obligation related to the bed is satisfied at a point in time. The performance obligation related to SleepIQ technology is satisfied over time based on the ongoing access and usage by the customer of software essential to the functionality of SleepIQ technology. The deferred revenue and costs related to SleepIQ technology are recognized on a straight-line basis over the product's estimated life of four years because our inputs are generally expended evenly throughout the performance period.

See Note 9, *Revenue Recognition*, for additional information on revenue recognition.

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	Sales & Marketing
• 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.	• 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	R&D[(1)]
• 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.	• 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. Deferred rent is included in our consolidated balance sheets as follows (in thousands):

	December 29, 2018	December 30, 2017
Deferred rent included in:		
Other current liabilities	$ 1,408	$ 1,447
Other non-current liabilities	11,452	9,555
	$ 12,860	$ 11,002

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. Deferred lease incentives are included in our consolidated balance sheets as follows (in thousands):

	December 29, 2018	December 30, 2017
Deferred lease incentives included in:		
Other current liabilities	$ 2,842	$ 2,784
Other non-current liabilities	11,930	9,688
	$ 14,772	$ 12,472

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 $210 million, $194 million and $190 million in 2018, 2017 and 2016, respectively. Advertising costs deferred and included in prepaid expenses in our consolidated balance sheets were $2 million and $2 million as of December 29, 2018 and December 30, 2017, 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 $9 million at December 29, 2018 and December 30, 2017, respectively. At December 29, 2018, and December 30, 2017, $5 million and $6 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.

We capitalize costs incurred with the implementation of a cloud computing arrangement, that is a service contract, consistent with our policy for software developed or obtained for internal use. The capitalized implementation costs of cloud computing arrangements are expensed over the term of the cloud computing arrangement in the same line item in the statement of operations as the associated fees.

Stock-Based Compensation

We compensate officers, directors and key employees with stock-based compensation under stock plans approved by our shareholders and administered under the supervision of our Board of Directors (Board). At December 29, 2018, a total of 2.3 million shares were available for future grant. 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.

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 2018, 2017 and 2016 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 2018, 2017 and 2016, the performance targets are based on growth in net sales and in operating profit, and the performance periods are fiscal 2018 through 2020, 2017 through 2019, and fiscal 2016 through 2018, respectively.

See Note 8, *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>

Adoption of ASC Topic 230, *Restricted Cash*

Effective December 31, 2017, we adopted ASC Topic 230, *Restricted Cash*, which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. Amounts for prior periods have been retrospectively adjusted to conform to the current period presentation.

Adoption of ASC Topic 606, *Revenue from Contracts with Customers*

On December 31, 2017, we adopted ASC Topic 606, *Revenue from Contracts with Customers*, using the modified retrospective method applied to those contracts which were not completed as of December 30, 2017. Results for reporting periods beginning after December 30, 2017 are presented under the new guidance, while prior period amounts are not restated.

The cumulative effect of the changes made to our consolidated balance sheet as of December 31, 2017 resulting from the adoption of the new revenue guidance was not material and did not impact opening retained earnings. The impact on the timing of net sales for 2018, as a result of applying the new guidance, was not material.

Practical expedients and exemptions permissible under ASC Topic 606 that we elected are as follows: we do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less; and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

See Note 9, *Revenue Recognition*, for further details regarding our revenue recognition policy.

Accounting Guidance Issued but Not Yet Adopted as of December 29, 2018

We are the lessee under various agreements for facilities, equipment and vehicles that are currently accounted for as operating leases. In February 2016, the FASB issued ASC Topic 842, *Leases*, that requires most leases to be recognized on the balance sheet and expands disclosure requirements. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

This new guidance is effective for us beginning December 30, 2018 (fiscal 2019). The provisions of this new guidance require a modified-retrospective approach, with elective reliefs. The new guidance will apply to all leases existing at the date of initial application. We have the option to choose either (1) the effective date, or (2) the beginning of the earliest comparative period presented in the financial statements as the date of initial application. We expect to adopt the new standard using the effective date option.

The new guidance establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. On adoption, we expect to recognize additional lease liabilities and corresponding ROU assets of approximately $300 million based on the present value of the remaining minimum rental payments for existing operating leases.

The new guidance provides a number of optional practical expedients in transition. We expect to elect the package of practical expedients, which permits us to not reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs. We do not expect to elect the use of hindsight. The new guidance also provides practical expedients for an entity's ongoing accounting. We expect to elect the short-term lease recognition exemption for all leases that qualify, primarily small equipment leases. This means, for those leases that qualify, we will not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition. We also expect to elect the practical expedient option to not separate lease and non-lease components for all of our leases.

We will be providing significant new disclosures about our leasing activities and have implemented a new lease accounting system in connection with the adoption. We also expect that adoption of the new guidance will require changes to our internal controls over financial reporting. We continue to evaluate the effect of the new standard on our consolidated financial statements and related disclosures.

(2) Fair Value Measurements

At December 29, 2018 and December 30, 2017, we had $6 million and $4 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 $6 million and $4 million at December 29, 2018 and December 30, 2017, respectively, which are included in other non-current liabilities. The majority of the debt and equity securities are Level 1 as they trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. Unrealized gains/(losses) on the debt and equity securities offset those associated with the corresponding deferred compensation plan liabilities.

(3) Inventories

Inventories consisted of the following (in thousands):

	December 29, 2018	December 30, 2017
Raw materials	$ 4,549	$ 6,577
Work in progress	3	170
Finished goods	80,330	77,551
	$ 84,882	$ 84,298

Finished goods inventories consisted of the following (in thousands):

	December 29, 2018	December 30, 2017
Finished beds, including retail display beds and deliveries in-transit to those customers who have utilized home delivery services	$ 25,313	$ 24,825
Finished components that were ready for assembly for the completion of beds	38,665	34,709
Retail accessories	16,352	18,017
	$ 80,330	$ 77,551

(4) Property and Equipment

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

	December 29, 2018	December 30, 2017
Land	$ 1,999	$ 1,999
Leasehold improvements	109,722	102,495
Furniture and equipment	108,841	94,265
Production machinery, computer equipment and software	238,659	224,758
Construction in progress	10,385	5,661
Less: Accumulated depreciation and amortization	(263,975)	(220,532)
	$ 205,631	$ 208,646

(5) Goodwill and Intangible Assets, Net

Goodwill and Indefinite-Lived Intangible Assets

Goodwill was $64 million at December 29, 2018 and December 30, 2017. Indefinite-lived trade name/trademarks totaled $1.4 million at December 29, 2018 and December 30, 2017.

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 29, 2018		December 30, 2017	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Developed technologies	$ 18,851	$ 8,886	$ 18,851	$ 6,705
Trade names/trademarks	101	101	101	101
	$ 18,952	$ 8,987	$ 18,952	$ 6,806

Amortization expense in 2018, 2017 and 2016 for definite-lived intangible assets was $2 million, $3 million and $2 million, respectively. Annual amortization for definite-lived intangible assets for subsequent years are as follows (in thousands):

2019	$	2,180
2020		2,213
2021		2,181
2022		2,181
2023		1,210
Thereafter		—
Total future amortization for definite-lived intangible assets	$	9,965

(6) Leases

Rent expense was as follows (in thousands):

Facility Rents:		2018		2017		2016
Minimum rents	$	71,851	$	66,239	$	59,002
Contingent rents		1,847		2,845		3,099
Total	$	73,698	$	69,084	$	62,101
Equipment Rents	$	5,692	$	4,935	$	5,316

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

2019	$	78,337
2020		73,331
2021		66,491
2022		59,515
2023		51,076
Thereafter		149,318
Total future minimum lease payments	$	478,068

We also had $0.9 million in capital lease commitments at December 29, 2018.

(7) Credit Agreement

Our revolving credit facility as of December 29, 2018, had a net aggregate availability of $300 million. The credit facility is for general corporate purposes, to meet our seasonal working capital requirements and to repurchase our stock. 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. We were in compliance with all financial covenants as of December 29, 2018.

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

	December 29, 2018	December 30, 2017
Outstanding borrowings	$ 199,600	$ 24,500
Outstanding letters of credit	$ 3,497	$ 3,150
Additional borrowing capacity	$ 96,903	$ 125,500
Weighted-average interest rate	4.2%	3.1%

In February 2019, we amended our revolving credit facility (Credit Agreement, as amended) to increase our net aggregate availability from $300 million to $450 million. We maintained the accordion feature which allows us to increase the amount of the credit facility from $450 million to $600 million, subject to Lenders' approval. The Credit Agreement, as amended, matures in February 2024. There were no other significant changes to the credit facility's terms and conditions.

(8) Shareholders' Equity

Stock-Based Compensation Expense

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

	2018	2017	2016
Stock options	$ 2,482	$ 2,344	$ 2,281
Stock awards	8,930	13,419	9,680
Total stock-based compensation expense[(1)]	11,412	15,763	11,961
Income tax benefit	2,750	5,249	3,947
Total stock-based compensation expense, net of tax	$ 8,662	$ 10,514	$ 8,014

[(1)] Decrease in 2018 stock-based compensation expense reflects the cumulative impact of the change in the expected achievements of certain performance targets.

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 30, 2017	1,355	$ 20.23	6.2	$ 23,515
Granted	170	33.72		
Exercised	(186)	14.96		
Canceled/Forfeited	(17)	26.43		
Outstanding at December 29, 2018	1,322	$ 22.64	5.9	$ 13,009
Exercisable at December 29, 2018	898	$ 20.76	4.8	$ 10,332
Vested and expected to vest at December 29, 2018	1,295	$ 22.55	5.9	$ 12,841

[(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):

	2018	2017	2016
Weighted-average grant date fair value of stock options granted	$ 13.96	$ 10.33	$ 8.85
Total intrinsic value (at exercise) of stock options exercised	$ 3,459	$ 3,586	$ 2,088

Cash received from the exercise of stock options for the fiscal year ended December 29, 2018 was $2.8 million. Our tax benefit related to the exercise of stock options for the fiscal year ended December 29, 2018 was $0.8 million.

At December 29, 2018, there was $2.7 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 1.7 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 2018 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	2018	2017	2016
Expected dividend yield	NA	NA	0%
Expected volatility	NA	NA	50%
Risk-free interest rate	NA	NA	1.8%

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	2018	2017	2016
Expected dividend yield	0%	0%	0%
Expected volatility	43%	46%	50%
Risk-free interest rate	2.7%	2.0%	1.4%
Expected term (in years)	5.0	5.1	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 30, 2017	395	$ 23.77	1,063	$ 23.41
Granted	222	33.53	200	34.46
Vested	(172)	24.28	(151)	33.34
Canceled/Forfeited	(62)	26.76	(51)	27.44
Outstanding at December 29, 2018	383	$ 28.66	1,061	$ 23.91

At December 29, 2018, there was $4.2 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 $12.4 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 1.9 years.

During 2018, 5,027 performance-based stock awards with a market condition were granted and had a weighted-average grant date fair value of $35.97 per award. These stock awards are reflected in the "Performance- and Market-Based Stock Awards" column in the stock award activity table above. 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. There were no market-based stock awards granted in 2016.

The assumptions used to calculate the fair value of the 2018 and 2017 performance-based stock awards with a market condition, using the Monte Carlo simulation model, were as follows:

Valuation Assumptions	**2018**	**2017**	**2016**
Expected dividend yield	0%	0%	NA
Expected volatility	43%	46%	NA
Risk-free interest rate	2.6%	1.5%	NA

Repurchases of Common Stock

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

	2018	**2017**	**2016**
Amount repurchased under Board-approved share repurchase program	$ 279,101	$ 150,000	$ 125,000
Amount repurchased in connection with the vesting of employee restricted stock grants	3,344	5,245	1,693
Total amount repurchased	$ 282,445	$ 155,245	$ 126,693

As of December 29, 2018, the remaining authorization under our Board-approved share repurchase program was $186 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):

	2018	**2017**	**2016**
Net income	$ 69,539	$ 65,077	$ 51,417
Reconciliation of weighted-average shares outstanding:			
Basic weighted-average shares outstanding	35,256	41,212	46,154
Dilutive effect of stock-based awards	909	873	748
Diluted weighted-average shares outstanding	36,165	42,085	46,902
Net income per share – basic	$ 1.97	$ 1.58	$ 1.11
Net income per share – diluted	$ 1.92	$ 1.55	$ 1.10

Additional potential dilutive stock options totaling 0.2 million, 0.4 million and 0.6 million for 2018, 2017 and 2016, 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).

(9) Revenue Recognition

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

	December 29, 2018	December 30, 2017
Deferred Contract Liabilities included in:		
Other current liabilities	$ 32,395	$ 29,534
Other non-current liabilities	42,194	43,159
	$ 74,589	$ 72,693

	December 29, 2018	December 30, 2017
Deferred Contract Assets included in:		
Other current assets	$ 20,553	$ 17,208
Other non-current assets	29,456	25,772
	$ 50,009	$ 42,980

During the year ended December 29, 2018, we recognized revenue of $30 million that was included in the deferred contract liability balance at the beginning of the year.

Revenue from goods and services transferred to customers at a point in time accounted for approximately 98% of our revenues for 2018 and 2017.

Net sales from each of our channels was as follows (in thousands):

	2018	2017
Retail	$ 1,401,991	$ 1,324,690
Online and phone	115,831	101,145
Company-Controlled channel	1,517,822	1,425,835
Wholesale/Other channel	13,753	18,662
Total	$ 1,531,575	$ 1,444,497

Obligation for Sales Returns

We accept sales returns during a 100-night trial period. Accrued sales returns represent a refund liability for the amount of consideration that we do not expect to be entitled to because it will be refunded to customers. The refund liability estimate is based on historical return rates and is adjusted for any current trends as appropriate. Each reporting period we remeasure the liability to reflect changes in the estimate, with a corresponding adjustment to net sales. The activity in the sales returns liability account for 2018 and 2017 was as follows (in thousands):

	2018	2017
Balance at beginning of year	$ 19,270	$ 15,222
Additions that reduce net sales	79,326	77,226
Deduction from reserves	(78,689)	(73,178)
Balance at end of period	$ 19,907	$ 19,270

(10) Profit Sharing and 401(k) Plan

Under our profit sharing and 401(k) plan, eligible employees may defer up to 50% of their compensation on a pre-tax basis, subject to Internal Revenue Service limitations. Each year, we may make a discretionary contribution equal to a percentage of the employee's contribution. During 2018, 2017 and 2016, our contributions, net of forfeitures, were $5 million, $5 million and $5 million, respectively.

(11) Other Expense, Net

Other expense, net, consisted of the following (in thousands):

	2018	2017	2016
Interest expense	$ 5,911	$ 975	$ 811
Interest income	(4)	(98)	(94)
Other expense, net	$ 5,907	$ 877	$ 717

(12) Income Taxes

Income tax expense consisted of the following (in thousands):

	2018	2017	2016
Current:			
Federal	$ 12,483	$ 19,153	$ 21,634
State	2,871	4,046	5,289
	15,354	23,199	26,923
Deferred:			
Federal	708	2,734	(105)
State	920	28	(2,302)
	1,628	2,762	(2,407)
Income tax expense	$ 16,982	$ 25,961	$ 24,516

The following table provides a reconciliation between the statutory federal income tax rate and our effective income tax rate:

	2018	2017	2016
Statutory federal income tax	21.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.3	2.5	2.6
Manufacturing deduction	—	(3.5)	(3.3)
Tax Cuts and Jobs Act effects	(3.9)	(1.9)	—
Changes in unrecognized tax benefits	1.2	(0.6)	1.2
R&D tax credits	(2.0)	(1.1)	(1.4)
Other	—	(1.9)	(1.8)
Effective income tax rate	19.6%	28.5%	32.3%

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 2015 or state income tax examinations prior to 2014.

On December 22, 2017, the Tax Cuts and Jobs Act (TCJA) was enacted. The TCJA reduced 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 was 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. During 2018, we updated our provisional tax benefit based on new information, including a tax planning analysis, and recorded an additional $2.9 million tax benefit.

The TCJA has significant complexity and our 2018 tax liability may differ from these estimates, due to, among other things, guidance that may be issued by the U.S. Treasury Department, the Internal Revenue Service, state tax jurisdictions, and related interpretations and clarifications of tax law.

Deferred Income Taxes

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

	2018	2017
Deferred tax assets:		
Stock-based compensation	$ 7,633	$ 6,940
Deferred rent and lease incentives	6,994	6,007
Warranty and returns liabilities	6,857	6,602
Net operating loss carryforwards and credits	2,324	3,240
Compensation and benefits	3,699	3,315
Other	3,406	3,321
Total gross deferred tax assets	30,913	29,425
Valuation allowance	(615)	(615)
Total gross deferred tax assets after valuation allowance	30,298	28,810
Deferred tax liabilities:		
Property and equipment	29,912	21,475
Deferred revenue	1,749	723
Other	3,459	3,987
Total gross deferred tax liabilities	35,120	26,185
Net deferred tax (liabilities) assets	$ (4,822)	$ 2,625

At December 29, 2018, we had net operating loss carryforwards for federal purposes of $1 million, which will expire between 2025 and 2027, and for state income tax purposes of $6 million, which will expire between 2028 and 2038.

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 2015 acquisition of BAM Labs, Inc.

Unrecognized Tax Benefits

Reconciliations of the beginning and ending amounts of unrecognized tax benefits were as follows (in thousands):

	Federal and State Tax		
	2018	2017	2016
Beginning balance	$ 2,839	$ 3,460	$ 2,077
Increases related to current-year tax positions	778	330	326
Increases related to prior-year tax positions	595	87	1,594
Decreases related to prior-year tax positions	—	(1,038)	—
Lapse of statute of limitations	(333)	—	(333)
Settlements with taxing authorities	(13)	—	(204)
Ending balance	$ 3,866	$ 2,839	$ 3,460

As of December 29, 2018 and December 30, 2017, we had $4 million and $3 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.

(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. If a loss is reasonably possible but not known or probable, and may be reasonably estimated, the estimated loss or range of loss is disclosed. With respect to currently pending legal proceedings, we have not established an estimated range of reasonably possible 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 pending legal proceedings to have a material effect on our consolidated results of operations, financial position or cash flows. Litigation, however, is inherently unpredictable, and it is possible that the ultimate outcome of one or more claims asserted against us could adversely impact our consolidated results of operations, financial position or cash flows. We expense legal costs as incurred.

On 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 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 accepted the certified questions and on April 16, 2018, ruled in our favor on one of the two questions, holding that a consumer only has standing to bring a claim under the relevant statute if the consumer has been harmed by the defendant's conduct. The Third Circuit remanded the case to the federal district court, which initially allowed the plaintiffs to file its proposed amended complaint, but thereafter rescinded its order and then denied Plaintiffs' request to file the amended complaint. We plan to ask the Court to dismiss the case.

On September 18, 2018, former Home Delivery Technician, Donald Cassels, and former Field Services Delivery Assistant, Jose Cadenas, filed suit in Superior Court in San Francisco County, California alleging representative claims on a purported class action basis under the California Labor Code Private Attorney General Act. While the two representative plaintiffs were in the Home Delivery workforce, the Complaint does not limit the purported plaintiff class to that group. The plaintiffs allege that Sleep Number failed or refused to adopt adequate practices, policies and procedures relating to wage payments, record keeping, employment disclosures, meal and rest breaks, among other claims, under California law. The plaintiffs purport to represent all former and current Sleep Number employees in the State of California aggrieved by the alleged practices. The Complaint seeks damages in the form of civil penalties and plaintiffs' attorneys' fees, and expressly disclaims the recovery of any purported individual specific relief or underpaid wages. After Sleep Number raised issues with the plaintiffs' choice of venue, the Court transferred venue from the Superior Court in San Francisco County to Superior Court in Fresno County. We intend to vigorously defend this matter.

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 29, 2018, we had $32 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 29, 2018, we had entered into 46 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 $62 million over the initial lease term. The minimum rentals for these lease commitments have been included in the future minimum lease payments in Note 6, *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.

2018	First	Second	Third	Fourth	Fiscal Year
Net sales	$ 388,633	$ 316,338	$ 414,779	$ 411,825	$ 1,531,575
Gross profit	237,477	188,888	250,517	251,079	927,961
Operating income	26,901	2,086	25,321	38,120	92,428
Net income	20,548	3,744	18,257	26,990	69,539
Net income per share – diluted	$ 0.52	$ 0.10	$ 0.52	$ 0.81	$ 1.92

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

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 29, 2018. 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 29, 2018 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 2019 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 2019 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 2019 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 2019 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 2019 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 2019 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. Sleep Number 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. Sleep Number 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. Sleep Number Executive Investment Plan (December 1, 2014 Restatement)
11. Employment Offer Letter from Sleep Number Corporation to Shelly R. Ibach dated February 9, 2007
12. Sleep Number Corporation Executive Physical Plan
13. Summary of Executive Tax and Financial Planning Program
14. Amended and Restated Sleep Number Corporation Executive Severance Pay Plan
15. First Amendment to Amended and Restated Sleep Number Corporation Executive Severance Pay Plan
16. 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 29, 2018

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)
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)

Exhibit No.	Description	Method of Filing
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	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)
10.19	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)
10.20	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)
10.21	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)
10.22	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)
10.23	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)
10.24	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)
10.25	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)

Exhibit No.	Description	Method of Filing
10.26	Third Amendment to Retailer Program Agreement, dated June 26, 2018 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 30, 2018 (File No. 0-25121)
10.27	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)
10.28	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	Incorporated by reference to Exhibit 10.29 contained in Sleep Number's Annual Report on Form 10-K filed for the fiscal year ended December 30, 2017 (File No. 0-25121)
10.29	First Amendment to Amended and Restated Credit and Security Agreement, dated as of February 11, 2019 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	Incorporated by reference to Exhibit 21.1 contained in Sleep Number's Annual Report on Form 10-K for the fiscal year ended December 30, 2017 (File No. -25121)
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
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 29, 2018, filed with the SEC on February 26, 2019, formatted in eXtensible Business Reporting Language: (i) Consolidated Balance Sheets as of December 29, 2018 and December 30, 2017; (ii) Consolidated Statements of Operations for the years ended December 29, 2018, December 30, 2017 and December 31, 2016; (iii) Consolidated Statements of Comprehensive Income for the years ended December 29, 2018, December 30, 2017 and December 31, 2016; (iv) Consolidated Statements of Shareholders' Equity for the years ended December 29, 2018, December 30, 2017 and December 31, 2016; (v) Consolidated Statements of Cash Flows for the years ended December 29, 2018, December 30, 2017 and December 31, 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 26, 2019

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 Sam R. Hellfeld, 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, 2019
/s/ Shelly R. Ibach Shelly R. Ibach	Director	February 26, 2019
/s/ Daniel I. Alegre Daniel I. Alegre	Director	February 25, 2019
/s/ Stephen L. Gulis, Jr. Stephen L. Gulis, Jr.	Director	February 24, 2019
/s/ Michael J. Harrison Michael J. Harrison	Director	February 21, 2019
/s/ Deborah L. Kilpatrick Deborah L. Kilpatrick	Director	February 25, 2019
/s/ Brenda J. Lauderback Brenda J. Lauderback	Director	February 25, 2019
/s/ Barbara R. Matas Barbara R. Matas	Director	February 25, 2019
/s/ Kathleen L. Nedorostek Kathleen L. Nedorostek	Director	February 25, 2019
/s/ Vicki A. O'Meara Vicki A. O'Meara	Director	February 22, 2019
/s/ Michael A. Peel Michael A. Peel	Director	February 26, 2019

SLEEP NUMBER CORPORATION AND SUBSIDIARIES
Schedule II - Valuation and Qualifying Accounts
(in thousands)

Description	2018	2017	2016
Allowance for doubtful accounts			
Balance at beginning of period	$ 714	$ 884	$ 1,039
Additions charged to costs and expenses	815	915	1,224
Deductions from reserves	(830)	(1,085)	(1,379)
Balance at end of period	$ 699	$ 714	$ 884

sleep number®