

Edgar Filing: STANDARD MOTOR PRODUCTS INC - Form 10-Q

STANDARD MOTOR PRODUCTS INC

Form 10-Q

November 09, 2006

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES  
EXCHANGE ACT OF 1934.

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2006

OR

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

COMMISSION FILE NUMBER: 1-4743

STANDARD MOTOR PRODUCTS, INC.  
-----

(Exact name of registrant as specified in its charter)

NEW YORK  
-----

(State or other jurisdiction of  
incorporation or organization)

11-1362020  
-----

(I.R.S. Employer  
Identification No.)

37-18 NORTHERN BLVD., LONG ISLAND CITY, N.Y.  
-----

(Address of principal executive offices)

11101  
-----

(Zip Code)

(718) 392-0200  
-----

(Registrant's telephone number, including area code)

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 is a large accelerated filer, an  
accelerated filer, or a non-accelerated filer. See definition of "accelerated  
filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check  
one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in  
Rule 12b-2 of the Exchange Act).

Yes  No

As of the close of business on October 31, 2006, there were 18,570,873  
outstanding shares of the registrant's Common Stock, par value \$2.00 per share.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

September 30, D  
2006

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(Unaudited)

| ASSETS  |            |
|---|------------|
| CURRENT ASSETS:   |            |
| Cash and cash equivalents .....   | \$ 15,019  |
| Accounts receivable, less allowance for discounts and doubtful<br>accounts of \$10,074 and \$9,574 for 2006 and 2005, respectively .... | 231,672    |
| Inventories .....   | 228,098    |
| Deferred income taxes .....   | 14,287     |
| Prepaid expenses and other current assets .....   | 9,511      |
| <hr/>   |            |
| Total current assets .....  | 498,587    |
| Property, plant and equipment, net .....  | 81,326     |
| Goodwill and other intangibles, net .....   | 56,787     |
| Other assets .....  | 35,096     |
| <hr/>   |            |
| Total assets .....  | \$ 671,796 |
| <hr/>   |            |
| LIABILITIES AND STOCKHOLDERS' EQUITY  |            |
| CURRENT LIABILITIES:  |            |
| Notes payable .....   | \$ 157,497 |
| Current portion of long-term debt .....   | 542        |
| Accounts payable .....  | 55,414     |
| Sundry payables and accrued expenses .....  | 24,656     |
| Accrued customer returns .....  | 30,869     |
| Restructuring accrual .....   | 861        |
| Accrued rebates .....   | 21,059     |
| Payroll and commissions .....   | 18,115     |
| <hr/>   |            |
| Total current liabilities .....   | 309,013    |
| <hr/>   |            |
| Long-term debt .....  | 98,127     |
| Post-retirement medical benefits and other accrued liabilities .....  | 47,442     |
| Restructuring accrual .....   | 418        |
| Accrued asbestos liabilities .....  | 20,903     |
| <hr/>   |            |
| Total liabilities .....   | 475,903    |
| <hr/>   |            |
| Commitments and contingencies   |            |
| Stockholders' equity:   |            |
| Common stock - par value \$2.00 per share:  |            |
| Authorized - 30,000,000 shares; issued 20,486,036 shares .....  | 40,972     |
| Capital in excess of par value .....  | 57,325     |
| Retained earnings .....   | 115,959    |
| Accumulated other comprehensive income .....  | 6,148      |
| Treasury stock - at cost 2,179,854 and 2,315,645 shares in<br>2006 and 2005, respectively .....   | (24,511)   |
| <hr/>   |            |
| Total stockholders' equity .....  | 195,893    |
| <hr/>   |            |
| Total liabilities and stockholders' equity .....  | \$ 671,796 |
| <hr/>   |            |

See accompanying notes to consolidated financial statements.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (In thousands, except share and per share data)

|   | Three Months Ended<br>September 30, |            | Nine Months<br>September |            |
|---|-------------------------------------|------------|--------------------------|------------|
|   | 2006<br>(Unaudited)                 | 2005       | 2006<br>(Unaudited)      | 2005       |
| Net sales .....   | \$ 203,755                          | \$ 224,438 | \$ 643,005               | \$ 643,005 |
| Cost of sales .....   | 154,423                             | 175,301    | 483,736                  | 483,736    |
| Gross profit .....  | 49,332                              | 49,137     | 159,269                  | 159,269    |
| Selling, general and administrative expenses ...                    | 40,039                              | 39,134     | 126,822                  | 126,822    |
| Restructuring expenses .....  | 598                                 | 218        | 828                      | 828        |
| Operating income .....  | 8,695                               | 9,785      | 31,619                   | 31,619     |
| Other income, net .....   | 820                                 | 67         | 1,980                    | 1,980      |
| Interest expense .....  | 5,118                               | 4,552      | 14,826                   | 14,826     |
| Earnings from continuing operations<br>before taxes .....           | 4,397                               | 5,300      | 18,773                   | 18,773     |
| Provision for income tax .....                                      | 1,814                               | 1,137      | 8,137                    | 8,137      |
| Earnings from continuing operations .....                           | 2,583                               | 4,163      | 10,636                   | 10,636     |
| Income (loss) from discontinued operation .....                     | 1,656                               | (449)      | 603                      | 603        |
| Net earnings .....  | 4,239                               | 3,714      | 11,239                   | 11,239     |
| Retained earnings at beginning of period .....                      | 113,368                             | 115,694    | 109,649                  | 109,649    |
| Less: cash dividends for period .....                               | 117,607                             | 119,408    | 120,888                  | 120,888    |
|   | 1,648                               | 1,760      | 4,929                    | 4,929      |
| Retained earnings at end of period .....                            | \$ 115,959                          | \$ 117,648 | \$ 115,959               | \$ 117,648 |
| <b>PER SHARE DATA:</b>  |                                     |            |                          |            |
| Net earnings per common share - Basic:                              |                                     |            |                          |            |
| Earnings from continuing operations .....                           | \$ 0.14                             | \$ 0.21    | \$ 0.58                  | \$ 0.58    |
| Discontinued operation .....  | 0.09                                | (0.02)     | 0.03                     | 0.03       |
| Net earnings per common share - Basic .....                         | \$ 0.23                             | \$ 0.19    | \$ 0.61                  | \$ 0.61    |
| Net earnings per common share - Diluted:                            |                                     |            |                          |            |
| Earnings from continuing operations .....                           | \$ 0.14                             | \$ 0.21    | \$ 0.58                  | \$ 0.58    |
| Discontinued operation .....  | 0.09                                | (0.02)     | 0.03                     | 0.03       |
| Net earnings per common share - Diluted .....                       | \$ 0.23                             | \$ 0.19    | \$ 0.61                  | \$ 0.61    |
| Average number of common shares .....                               | 18,306,178                          | 19,547,319 | 18,265,784               | 18,265,784 |
| Average number of common shares and dilutive<br>common shares ..... | 18,371,435                          | 19,577,972 | 18,297,979               | 18,297,979 |

See accompanying notes to consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

|   | Nine Months Ended<br>September 30, |       |
|---|------------------------------------|-------|
|   | 2006                               | 2005  |
|   | -----<br>(Unaudited)               |       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                    |       |
| Net earnings  | \$ 11,239                          | \$    |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities: |                                    |       |
| Depreciation and amortization   | 12,016                             | 1     |
| Increase in allowance for doubtful accounts   | 176                                |       |
| Increase in inventory reserves  | 3,617                              |       |
| Loss on disposal of property, plant and equipment   | 2                                  |       |
| Equity income from joint ventures   | (865)                              |       |
| Employee stock ownership plan allocation  | 893                                |       |
| Stock-based compensation  | 695                                |       |
| Increase in tax valuation allowance   | --                                 |       |
| Decrease (increase) in deferred income taxes  | 6,931                              | (     |
| (Income) loss from discontinued operation   | (603)                              |       |
| Change in assets and liabilities:   |                                    |       |
| Increase in accounts receivable   | (55,554)                           | (11   |
| Decrease in inventories   | 11,582                             | 1     |
| Increase in prepaid expenses and other current assets   | (589)                              | (     |
| Decrease in other assets  | 2,781                              |       |
| Increase in accounts payable  | 8,193                              |       |
| Decrease in sundry payables and accrued expenses  | (2,768)                            | (     |
| Decrease in restructuring accrual   | (902)                              | (     |
| Increase in other liabilities   | 12,153                             | 1     |
|   | -----                              | ----- |
| Net cash provided by (used in) operating activities   | 8,997                              | (6    |
|   | -----                              | ----- |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                    |       |
| Proceeds from the sale of property, plant and equipment                                       | 14                                 |       |
| Capital expenditures  | (7,664)                            | (     |
|   | -----                              | ----- |
| Net cash used in investing activities   | (7,650)                            | (     |
|   | -----                              | ----- |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                    |       |
| Net borrowings under line-of-credit agreements  | 8,261                              | 7     |
| Principal payments and retirement of long-term debt   | (422)                              |       |
| (Decrease) increase in overdraft balances   | (5,314)                            |       |
| Dividends paid  | (4,929)                            | (     |
|   | -----                              | ----- |
| Net cash (used in) provided by financing activities   | (2,404)                            | 6     |
|   | -----                              | ----- |
| Effect of exchange rate changes on cash   | 2,030                              |       |
|   | -----                              | ----- |
| Net increase (decrease) in cash and cash equivalents  | 973                                | (     |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD  | 14,046                             | 1     |
|   | -----                              | ----- |

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|   |           |       |
|---|-----------|-------|
| CASH AND CASH EQUIVALENTS AT END OF THE PERIOD              | \$ 15,019 | \$ 1  |
|   | =====     | ===== |
| Supplemental disclosure of cash flow information            |           |       |
| Cash paid during the period for:                            |           |       |
| Interest  | \$ 16,169 | \$ 1  |
|   | =====     | ===== |
| Income taxes  | \$ 2,855  | \$    |
|   | =====     | ===== |
| Non-cash financing activity:                                |           |       |
| Reduction of restructuring accrual applied against goodwill | \$ 10,453 | \$    |
|   | =====     | ===== |

See accompanying notes to consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
(In thousands)

THREE MONTHS ENDED SEPTEMBER 30, 2006  
(Unaudited)

|   | Common<br>Stock<br>----- | Capital in<br>Excess of<br>Par Value<br>----- | Retained<br>Earnings<br>----- | Accumulated<br>Other<br>Comprehensive<br>Income<br>----- |
|---|--------------------------|---|-------------------------------|--|
| Balance at June 30, 2006 .....  | \$ 40,972                | \$ 57,176                                     | \$113,368                     | \$ 5,609   |
| Comprehensive income:   |                          |   |                               |  |
| Net income .....  |                          |   | 4,239                         |  |
| Foreign currency translation<br>adjustment .....                      |                          |   |                               | 724  |
| Unrealized loss on interest rate<br>swap agreements, net of tax ..... |                          |   |                               | (110)  |
| Minimum pension liability<br>adjustment .....                         |                          |   |                               | (75)   |
| Total comprehensive income .....                                      |                          |   |                               |  |
| Cash dividends paid .....   |                          |   | (1,648)                       |  |
| Employee stock compensation .....                                     |                          | 149   |                               |  |
| Employee Stock Ownership Plan .....                                   |                          | --  |                               |  |
|   | -----                    | -----   | -----                         | -----  |
| Balance at September 30, 2006 .....                                   | \$ 40,972                | \$ 57,325                                     | \$115,959                     | \$ 6,148   |
|   | =====                    | =====   | =====                         | =====  |

NINE MONTHS ENDED SEPTEMBER 30, 2006  
(Unaudited)

|  | Common | Capital in<br>Excess of | Retained | Accumulated<br>Other<br>Comprehensive |
|--|--------|-------------------------|----------|---------------------------------------|
|--|--------|-------------------------|----------|---------------------------------------|

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|   | Stock<br>----- | Par Value<br>----- | Earnings<br>----- | Income<br>----- |
|---|----------------|--------------------|-------------------|-----------------|
| Balance at December 31, 2005 .....                                    | \$ 40,972      | \$ 56,966          | \$109,649         | \$ 4,158        |
| Comprehensive income:   |                |                    |                   |                 |
| Net income .....  |                |                    | 11,239            |                 |
| Foreign currency translation<br>adjustment .....                      |                |                    |                   | 2,412           |
| Unrealized loss on interest rate<br>swap agreements, net of tax ..... |                |                    |                   | (262)           |
| Minimum pension liability<br>adjustment .....                         |                |                    |                   | (160)           |
| Total comprehensive income .....                                      |                |                    |                   |                 |
| Cash dividends paid .....   |                |                    | (4,929)           |                 |
| Employee stock compensation .....                                     |                | 501                |                   |                 |
| Employee Stock Ownership Plan .....                                   |                | (142)              |                   |                 |
|   | -----          | -----              | -----             | -----           |
| Balance at September 30, 2006 .....                                   | \$ 40,972      | \$ 57,325          | \$115,959         | \$ 6,148        |
|   | =====          | =====              | =====             | =====           |

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

##### NOTE 1. BASIS OF PRESENTATION

Standard Motor Products, Inc. (referred to hereinafter in these notes to consolidated financial statements as the "Company," "we," "us," or "our") is engaged in the manufacture and distribution of replacement parts for motor vehicles in the automotive aftermarket industry.

The accompanying unaudited financial information should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005.

The unaudited consolidated financial statements include our accounts and all domestic and international companies in which we have more than a 50% equity ownership. Our investments in unconsolidated affiliates are accounted for on the equity method. All significant inter-company items have been eliminated.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the interim periods are not necessarily indicative of the results of operations for the entire year.

Where appropriate, certain amounts in 2005 have been reclassified to conform with the 2006 presentation.

##### NOTE 2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

###### SHARE-BASED PAYMENT

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In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). SFAS 123R requires that stock-based employee compensation be recorded as a charge to earnings. SFAS 123R is effective for interim and annual financial statements for years beginning after December 15, 2005 and applies to all outstanding and unvested share-based payments at the time of adoption. Accordingly, we have adopted SFAS 123R commencing January 1, 2006 using a modified prospective application, as permitted by SFAS 123R. Accordingly, prior period amounts have not been restated. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS 123R, we applied Accounting Principles Board Opinions ("APB") No. 25 and related interpretations to account for our stock plans resulting in the use of the intrinsic value to value the stock. Under APB 25, we were not required to recognize compensation expense for the cost of stock options. In accordance with the adoption of SFAS 123R, we recorded stock-based compensation expense for the cost of incentive stock options, restricted stock and performance-based stock granted under our stock plans. Stock-based compensation expense for the third quarter of 2006 was \$149,100 (\$91,600 net of tax) or \$0.01 per basic and diluted share and \$559,500 (\$343,800 net of tax) or \$0.02 per basic and diluted share for the nine months ended September 30, 2006. The adoption of SFAS 123R did not have a material impact on our financial position, results of operation or cash flows.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-(CONTINUED)

##### ACCOUNTING FOR UNCERTAIN TAX POSITIONS

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of this Interpretation. FIN 48 also provides guidance on accounting for derecognition, interest and penalties, and classification and disclosure of matters related to uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006 and, as a result, is effective for our Company beginning January 1, 2007. FIN 48 will require adjustment to the opening balance of retained earnings (or other components of shareholders' equity in the statement of financial position) for the cumulative effect of the difference in the net amount of assets and liabilities for all open tax positions at the effective date. Management is currently assessing the impact, if any, which the adoption of FIN 48 will have on our consolidated financial position, results of operations and cash flows.

##### FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair



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value measurements. SFAS 157 is effective for the fiscal year beginning after November 15, 2007, which for the Company is the year ending December 31, 2007. Management is currently assessing the impact, if any, which the adoption of SFAS 157 will have on our consolidated financial position, results of operations and cash flows.

### ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit pension or postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through accumulated other comprehensive income in shareholders' equity. This statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The Company will be required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006, which for the Company will be the year ending December 31, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008 or for the Company's year ending December 31, 2008. Management estimates the impact of adopting SFAS 158 will not result in a material change to its total liabilities or shareholders' equity.

### QUANTIFYING MISSTATEMENTS IN CURRENT YEAR FINANCIAL STATEMENTS

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB 108 requires registrants to quantify misstatements using both an income statement ("rollover") and balance sheet ("iron curtain") approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-(CONTINUED)

considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, the cumulative effect adjustment is recorded in opening accumulated earnings (deficit) as of the beginning of the fiscal year of adoption. SAB 108 is effective for fiscal years ending on or after November 15, 2006, which for the Company is the year ending December 31, 2006. Management is currently assessing the impact, if any, which the adoption of SAB 108 will have on our consolidated financial position, results of operations and cash flows.

### NOTE 3. RESTRUCTURING AND INTEGRATION COSTS

#### RESTRUCTURING COSTS

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In connection with our acquisition of substantially all of the assets and the assumption of substantially all of the operating liabilities of Dana Corporation's Engine Management Group ("DEM") on June 30, 2003, we have reviewed our operations and implemented integration plans to restructure the operations of DEM. At the time, we announced that we would close seven DEM facilities, which has subsequently occurred. As part of the integration and restructuring plans, we accrued an initial restructuring liability of approximately \$34.7 million at June 30, 2003. Such amounts were recognized as liabilities assumed in the acquisition and included in the allocation of the cost to acquire DEM. Accordingly, such amounts resulted in additional goodwill being recorded in connection with the acquisition. Subsequent to the acquisition, our estimate of the restructuring liability was updated and revised downward at various points in time, with a cumulative reduction to goodwill of \$12.6 million as of September 30, 2006. The remaining restructuring accrual was \$1.3 million as of September 30, 2006. We expect to pay most of this remaining amount in 2006 and 2007.

Of the initial restructuring accrual, approximately \$15.7 million related to work force reductions and represented employee termination benefits. The accrual amount primarily provides for severance costs relating to the involuntary termination of employees, individually employed throughout DEM's facilities across a broad range of functions, including managerial, professional, clerical, manufacturing and factory positions. During the year ended December 31, 2005 and the nine months ended September 30, 2006, termination benefits of \$2.3 million and \$0.1 million, respectively, have been charged to the restructuring accrual. As of September 30, 2006, the reserve balance for workforce reductions was at \$0.7 million.

The initial restructuring accrual also included approximately \$18 million consisting of the net present value of costs associated with exiting certain activities, primarily related to lease and contract termination costs, which will not have future benefits. Specifically, our plans were to consolidate certain of DEM operations into our existing plants. At December 31, 2005, we had a sublease commitment for one facility with Dana through 2021. However, on March 3, 2006, Dana filed a voluntary petition for relief under Chapter 11 of the US Bankruptcy Code. Pursuant to a court ruling in connection with Dana's Chapter 11 bankruptcy proceedings, effective March 31, 2006, we were released from, and no longer have any obligations with respect to, such lease commitment for the facility. We have accounted for the termination of such lease commitment as a reduction of \$10.5 million in our restructuring accrual, with a corresponding reduction to goodwill established on the acquisition of DEM. In addition to the above reduction, exit costs of \$0.8 million were paid as of September 30, 2006, leaving the exit reserve balance for exit costs at \$0.6 million as of September 30, 2006.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-(CONTINUED)

Selected information relating to the restructuring costs included in the allocation of the cost to acquire DEM is as follows (in thousands):

| Workforce<br>Reduction | Other<br>Costs | Exit | Total |
|------------------------|----------------|------|-------|
|------------------------|----------------|------|-------|

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|  |        |           |           |
|--|--------|-----------|-----------|
| Restructuring liability at December 31, 2005 .....     | \$ 809 | \$ 11,825 | \$ 12,634 |
| Cash payments during first nine months of 2006 .....   | (144)  | (758)     | (902)     |
| Adjustments during first nine months of 2006 .....     | --     | (10,453)  | (10,453)  |
|  | -----  | -----     | -----     |
| Restructuring liability as of September 30, 2006 ..... | \$ 665 | \$ 614    | \$ 1,279  |
|  | =====  | =====     | =====     |

### INTEGRATION EXPENSES

During the third quarter of 2006 and 2005, we incurred integration expenses of approximately \$0.6 million and \$0.2 million, respectively. For the nine months ended September 30, 2006 and 2005, we incurred integration expenses of \$0.8 million and \$4.6 million, respectively. The 2006 amount primarily relates to the cost of moving our European production operations and the divestiture of a production unit of our Temperature Control Segment. In the second quarter of 2005, the Company effected an asset write-down for the outsourcing of some of its Temperature Control product lines resulting in a \$3.5 million integration expense. The remainder of the 2005 costs are primarily due to the DEM integration.

### NOTE 4. INVENTORIES

|                              | September 30,<br>2006 | December 31,<br>2005 |  |
|------------------------------|-----------------------|----------------------|--|
| (in thousands)               |                       |                      |  |
| -----                        |                       |                      |  |
| Finished goods, net .....    | \$ 163,051            | \$ 182,567           |  |
| Work in process, net .....   | 4,703                 | 4,235                |  |
| Raw materials, net .....     | 60,344                | 56,495               |  |
|                              | -----                 | -----                |  |
| Total inventories, net ..... | \$ 228,098            | \$ 243,297           |  |
|                              | =====                 | =====                |  |

### NOTE 5. CREDIT FACILITIES AND LONG-TERM DEBT

Total debt consists of (in thousands):

|  | September 30,<br>2006 | December 31,<br>2005 |  |
|--|-----------------------|----------------------|--|
| -----  |                       |                      |  |
| <b>Current</b>                                 |                       |                      |  |
| Revolving credit facilities (1) .....          | \$ 157,497            | \$ 149,236           |  |
| Current portion of mortgage loan .....         | 542                   | 542                  |  |
|  | -----                 | -----                |  |
|  | 158,039               | 149,778              |  |
|  | -----                 | -----                |  |
| <b>Long-term Debt</b>                          |                       |                      |  |
| 6.75% convertible subordinated debentures .... | 90,000                | 90,000               |  |
| Mortgage loan .....                            | 8,543                 | 8,912                |  |
| Other .....                                    | 126                   | 179                  |  |
| Less: current portion of long-term debt .....  | 542                   | 542                  |  |
|  | -----                 | -----                |  |
|  | 98,127                | 98,549               |  |
|  | -----                 | -----                |  |
| Total debt .....                               | \$ 256,166            | \$ 248,327           |  |
|  | =====                 | =====                |  |

(1) Consists of the revolving credit facility, the Canadian term loan and the European revolving credit facility.

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-(CONTINUED)

Maturities of long-term debt during the five years ending December 31, 2006 through 2010 are \$0.5 million, \$0.5 million, \$0.5 million, \$90.5 million and \$0.6 million, respectively.

The Company had deferred financing costs of \$4.5 million and \$3.3 million as of December 31, 2005 and September 30, 2006, respectively. These costs related to the Company's revolving credit facility, the convertible subordinated debentures and a mortgage loan agreement, and these costs are being amortized over three to thirteen years.

## REVOLVING CREDIT FACILITY

We are parties to an agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The term of the credit agreement is through 2008 and provides for a line of credit up to \$305 million. Availability under our revolving credit facility is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. After taking into account outstanding borrowings under the revolving credit facility, there was an additional \$68.8 million available for us to borrow pursuant to the formula at September 30, 2006. Our credit agreement also permits dividends and distributions by us provided specific conditions are met.

At December 31, 2005 and September 30, 2006, the interest rate on the Company's revolving credit facility was 6.7% and 7.6%, respectively. Direct borrowings under our revolving credit facility bear interest at the prime rate plus the applicable margin (as defined) or, at our option, the LIBOR rate plus the applicable margin (as defined). Outstanding borrowings under the revolving credit facility (inclusive of the Canadian term loan described below), which are classified as current liabilities, were \$142.3 million and \$149.2 million at December 31, 2005 and September 30, 2006, respectively. The Company maintains cash management systems in compliance with its credit agreements. Such systems require the establishment of lock boxes linked to blocked accounts whereby cash receipts are channeled to various banks to insure pay-down of debt. Agreements also classify such accounts and the cash therein as additional security for loans and other obligations to the credit providers. Borrowings are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. The terms of our revolving credit facility provide for, among other provisions, financial covenants requiring us, on a consolidated basis, (1) to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months) through 2008, and (2) to limit capital expenditure levels for each fiscal year through 2008. The terms of our revolving credit facility also provide, among other things, for the prohibition of accepting drafts under our customer draft programs after November 18, 2005.

## CANADIAN TERM LOAN

In December 2005, our Canadian subsidiary entered into a credit agreement with GE Canada Finance Holding Company, for itself and as agent for the lenders, and GECC Capital Markets, Inc., as lead arranger and book runner. The credit agreement provides for, among other things, a \$7 million term loan, which term loan is guaranteed and secured by us and certain of our wholly-owned subsidiaries and which term loan is coterminous with the term of our revolving credit facility. The \$7 million term loan is part of the \$305 million available for borrowing under our revolving credit facility.

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## REVOLVING CREDIT FACILITY--EUROPE

Our European subsidiary has a revolving credit facility, which provides for a line of credit of up to \$8.5 million. The amount of short-term bank borrowings outstanding under this facility was \$7 million and \$8.3 million at December 31, 2005 and September 30, 2006, respectively. The weighted average interest rates on these borrowings at December 31, 2005 and September 30, 2006 were 6.5% and 5.9%, respectively. At September 30, 2006, there was an additional \$0.2 million available for our European subsidiary to borrow.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - (CONTINUED)

#### SUBORDINATED DEBENTURES

In July 1999, we completed a public offering of convertible subordinated debentures amounting to \$90 million. The convertible debentures carry an interest rate of 6.75%, payable semi-annually, and will mature in July 2009. The convertible debentures are convertible into 2,796,120 shares of our common stock at the option of the holder. We may, at our option, redeem some or all of the convertible debentures at any time on or after July 15, 2004, for a redemption price equal to the issuance price plus accrued interest. In addition, if a change in control, as defined in the agreement, occurs at the Company, we will be required to make an offer to purchase the convertible debentures at a purchase price equal to 101% of their aggregate principal amount, plus accrued interest. The convertible debentures are subordinated in right of payment to all of the Company's existing and future senior indebtedness.

#### MORTGAGE LOAN AGREEMENT

In June 2003, we borrowed \$10 million under a mortgage loan agreement. The loan is payable in monthly installments. The loan bears interest at a fixed rate of 5.50% maturing in July 2018. The mortgage loan is secured by a building and related property.

#### NOTE 6. COMPREHENSIVE INCOME

Comprehensive income, net of income tax expense is as follows (in thousands):

|   | Three Months Ended<br>September 30, |          | Nine Months End<br>September 30, |           |
|---|-------------------------------------|----------|----------------------------------|-----------|
|   | 2006                                | 2005     | 2006                             | 2005      |
|   | ----                                | ----     | ----                             | ----      |
| Net income as reported  | \$ 4,239                            | \$ 3,714 | \$ 11,239                        | \$ 10,812 |
| Foreign currency translation adjustment                             | 724                                 | 1,056    | 2,412                            | 2,412     |
| Minimum pension liability adjustment                                | (75)                                | 56       | (160)                            | (160)     |
| Unrealized (loss) gain on interest rate swap agreements, net of tax | (110)                               | 44       | (262)                            | (262)     |
|   | -----                               | -----    | -----                            | -----     |
| Total comprehensive income  | \$ 4,778                            | \$ 4,870 | \$ 13,229                        | \$ 12,802 |
|   | =====                               | =====    | =====                            | =====     |

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### NOTE 7. STOCK-BASED COMPENSATION PLANS

We have five stock-based compensation plans. Under the 1994 Omnibus Stock Option Plan, as amended, which terminated as of May 25, 2004, we were authorized to issue options to purchase 1,500,000 shares. The options become exercisable over a three to five year period and expire at the end of five years following the date they become exercisable. Under the 2004 Omnibus Stock Plan, which terminates as of May 20, 2014, we were authorized to issue options to purchase 500,000 shares. The options become exercisable over a three to five year period and expire at the end of ten years following the date of grant. Under the 1996 Independent Directors' Stock Option Plan and the 2004 Independent Directors' Stock Option Plan, we were authorized to issue options to purchase 50,000 shares under each plan. The options become exercisable one year after the date of grant and expire at the end of ten years following the date of grant. Under the 2006 Omnibus Incentive Plan, which was approved by our shareholders in May 2006, we are authorized to issue equity awards of up to 700,000 shares. Equity awards forfeited under the previous stock option plans and incentive plan are eligible to be granted again under the 2006 Omnibus Incentive Plan with respect to the equity awards so forfeited. At September 30, 2006, under our stock option plans, there were an aggregate of (a) 1,103,986 shares of common stock authorized for grants, (b) 1,059,311 shares of common stock granted, and (c) no shares of common stock available for future grants. At September 30, 2006, under our 2006 Omnibus Incentive Plan, there were an aggregate of (a) 700,000 shares of common stock authorized for grants, (b) 95,225 shares of common stock granted, and (c) 604,775 shares of common stock available for future grants.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - (CONTINUED)

Effective January 1, 2006, we adopted SFAS 123R, "Share-Based Payment," which prescribes the accounting for equity instruments exchanged for employee and director services. Under SFAS 123R, stock-based compensation cost is measured at the grant date, based on the calculated fair value of the grant, and is recognized as an expense over the service period applicable to the grantee. The service period is the period of time that the grantee must provide services to us before the stock-based compensation is fully vested. In March 2005, the SEC issued Staff Accounting Bulletin ("SAB") No. 107, "Share-Based Payment," relating to SFAS 123R. We have followed the SEC's guidance in SAB 107 in our adoption of SFAS 123R.

Prior to January 1, 2006, we accounted for stock-based compensation to employees and directors in accordance with the intrinsic value method under APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Under the intrinsic value method, no compensation expense was recognized in our financial statements for the stock-based compensation, because the stock-based compensation that we granted was incentive stock options and all of the stock options granted had exercise prices equivalent to the fair market value of our common stock on the grant date. We also followed the disclosure requirements of SFAS 123, "Accounting for Stock-Based Compensation," as amended, "Accounting for Stock-Based Compensation--Transition and Disclosure".

We adopted SFAS 123R using the modified prospective transition method. Under this transition method, the financial statement amounts for the periods before 2006 have not been restated to reflect the fair value method of expensing the stock-based compensation. The compensation expense recognized on or after January 1, 2006 includes the compensation cost based on the grant-date fair value estimated in accordance with: (a) SFAS 123 for all stock-based

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compensation that was granted prior to, but vested on or after, January 1, 2006; and (b) SFAS 123R for all stock-based compensation that was granted on or after January 1, 2006. Stock-based compensation expense for the third quarter of 2006 was \$149,100 (\$91,600 net of tax) or \$0.01 per basic and diluted share and \$559,500 (\$343,800 net of tax) or \$0.02 per basic and diluted share for the nine months ended September 30, 2006.

Had we determined compensation cost based on the fair value at the grant date for our pre-2006 stock option grants, our pro forma net income and net income per common share would have been as follows (in thousands, except per share data):

|   | Three Months Ended<br>September 30, 2005<br>----- | Nine Months Ended<br>September 30, 2005<br>----- |
|---|---|--|
| Net earnings as reported .....  | \$ 3,714  | \$ 2,695   |
| Less: Stock-based employee compensation expense<br>determined under fair value method for all awards,<br>net of related tax effects ..... | 183<br>-----                                      | 495<br>-----                                     |
| Pro forma net earnings .....  | \$ 3,531<br>=====                                 | \$ 2,200<br>=====                                |
| Earnings per share:   |   |  |
| Basic - as reported .....   | \$ 0.19<br>-----                                  | \$ 0.14<br>-----                                 |
| Basic - pro forma .....   | \$ 0.18<br>-----                                  | \$ 0.11<br>-----                                 |
| Diluted - as reported .....   | \$ 0.19<br>-----                                  | \$ 0.14<br>-----                                 |
| Diluted - pro forma .....   | \$ 0.18<br>-----                                  | \$ 0.11<br>-----                                 |

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - (CONTINUED)

##### Stock Option Grants

There were no stock options granted in the nine months ended September 30, 2006 and options to purchase 280,500 shares of common stock were granted in the nine months ended September 30, 2005. Accordingly, we have recognized compensation expense for prior years' grants which vest after January 1, 2006 based on the grant-date fair value, estimated in accordance with SFAS 123 which was used in our prior pro forma disclosure. Further, the current quarter's expense reflects our estimate of expected forfeitures which we determine to be immaterial, based on history and remaining time until vesting of the remaining options.

The stock options granted prior to 2006 have been vesting gradually at annual intervals. In our prior period SFAS 123 pro forma disclosures, our policy was to calculate the compensation expense related to the stock-based compensation granted to employees and directors on a straight-line basis over the full vesting period of the grants.

Prior to this year, we provided pro forma net income and net income per common

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share disclosures for stock option grants based on the fair value of the options at the grant date. For purposes of presenting pro forma information, the fair value of options granted is computed using the Black Scholes option pricing model with the following assumptions applicable to each remaining unvested annual grant:

| Year of Grant:                 | 2005   | 2004   | 2003   |
|--------------------------------|--------|--------|--------|
| -----                          | ----   | ----   | ----   |
| Expected option life.....      | 3.85   | 3.85   | 3.86   |
| Expected stock volatility..... | 39.05% | 38.57% | 39.16% |
| Expected dividend yield.....   | 3.3%   | 2.7%   | 2.6%   |
| Risk-free rate.....            | 4.00%  | 3.64%  | 2.76%  |

The expected term of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate is based on the US Treasury rates at the date of grant with maturity dates approximately equal to the expected life at the grant date. Volatility is based on historical volatility of the Company's common stock.

The following is a summary of the changes in outstanding stock options for the nine months ended September 30, 2006:

|   | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted Average<br>Remaining<br>Contractual<br>Term (years) |
|---|-----------|--|--|
|   | -----     | -----                                    | -----  |
| Outstanding at beginning<br>of year.....      | 1,249,226 | \$ 14.42                                 | 5.2  |
| Expired.....                                  | 180,665   | \$ 20.43                                 | 0  |
| Forfeited.....                                | 9,250     | \$ 12.70                                 | 6.4  |
| Outstanding at end of<br>Quarter.....         | 1,059,311 | \$ 13.40                                 | 5.3  |
| Options exercisable at end<br>of quarter..... | 928,186   | \$ 13.66                                 | 4.8  |

The aggregate intrinsic value of outstanding stock options was \$0.5 million, of which \$0.4 million relates to options that are exercisable.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - (CONTINUED)

The following is a summary of the changes in non-vested stock options for the nine months ended September 30, 2006:

|  | Shares  | Weighted<br>Average Grant<br>Date Fair Value |
|--|---------|--|
|  | -----   | -----  |
| Non-vested shares at January 1, 2006 .....   | 494,426 | \$ 3.04                                      |
| Forfeitures.....                             | 3,625   | \$ 2.87                                      |
| Vested.....                                  | 359,676 | \$ 3.16                                      |
| Non-vested shares at September 30, 2006..... | 131,125 | \$ 2.72                                      |
|  | =====   |  |



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Stock option-based compensation expense was \$89,200 (\$54,800 net of tax) for the third quarter of 2006 and \$461,400 (\$283,300 net of tax) for the nine months ended September 30, 2006. As of September 30, 2006, we have \$178,300 of total unrecognized compensation cost related to non-vested stock options granted under our various option-based plans, which we expect to recognize over a weighted-average period of 0.5 years. No stock options were exercised during the nine months ended September 30, 2006.

### Restricted and Performance Stock Grants

Under our 2006 Omnibus Incentive Plan, the Company is authorized to issue, among other things, shares of restricted and performance-based stock to eligible employees and directors. Prior to the time a restricted share becomes fully vested or a performance share is issued, the awardee cannot transfer, pledge, hypothecate or encumber such shares. Prior to the time a restricted share is fully vested, the awardee has all other rights of a stockholder, including the right to vote (but not receive dividends during the vesting period). Prior to the time a performance share is issued, the awardee shall have no rights as a stockholder. Restricted shares become fully vested upon the third and first anniversary of the date of grant for employees and directors, respectively. Performance-based shares are subject to a three year measuring period and the achievement of Company performance targets and, depending upon the achievement of such performance targets, then may become vested on the third anniversary of the date of grant. Management believes it is probable that the performance targets will be achieved.

All shares and rights are subject to forfeiture if certain employment conditions are not met. Under the plan, 700,000 shares are authorized to be issued. For the third quarter ended September 30, 2006, 7,900 restricted and performance-based shares were granted (4,150 restricted shares and 3,750 performance-based shares). For the nine months ended September 30, 2006, 95,225 restricted and performance-based shares were granted (67,725 restricted shares and 27,500 performance-based shares). In determining the grant date fair value for U.S. GAAP purposes, the stock price on the date of grant, as quoted on the New York Stock Exchange, was reduced by the present value of dividends expected to be paid on the shares issued and outstanding during the requisite service period, discounted at a risk-free interest rate. The risk-free interest rate is based on the U.S. Treasury rates at the date of grant with maturity dates approximately equal to the restriction or vesting period at the grant date. The fair value of the shares at the date of grant is amortized to expense ratably over the restriction period. For the quarter ended September 30, 2006, forfeitures are estimated at 2% for employees and 0% for executives and directors, respectively, based on evaluations of historical and expected future turnover.

The Company recorded compensation expense related to restricted shares and performance-based shares of \$59,900 (\$36,800 net of tax) and \$0 for the quarter ended September 30, 2006 and 2005, respectively, and \$98,100 (\$60,200 net of tax) and \$0 for the nine months ended September 30, 2006 and 2005, respectively. The unamortized compensation expense related to the Company's restricted and performance-based shares was \$575,900 at September 30, 2006 and is expected to be recognized over a weighted average period of 2.6 and 0.6 years for employees and directors, respectively.

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The Company's restricted and performance-based share activity was as follows for the nine months ended September 30, 2006:

|                                     | Shares | Weighted<br>Average Grant<br>Date Fair Value<br>Per Share |
|-------------------------------------|--------|---|
|                                     | -----  | -----   |
| Balance at January 1, 2006 .....    | --     | --  |
| Granted .....                       | 95,225 | \$ 7.21   |
| Vested .....                        | 200    | \$ 7.84   |
| Forfeited .....                     | --     | --  |
|                                     | -----  |   |
| Balance at September 30, 2006 ..... | 95,025 | \$ 7.21   |
|                                     | =====  |   |

The weighted-average grant date fair value of restricted and performance-based shares granted during the nine months ended September 30, 2006 was \$686,500, or \$7.21 per share. No restricted or performance-based shares were authorized, granted, outstanding or vested during the nine months ended September 30, 2005.

### NOTE 8. EARNINGS PER SHARE

The following are reconciliations of the earnings available to common stockholders and the shares used in calculating basic and dilutive net earnings per common share (in thousands, except share amounts):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2006                                | 2005       | 2006                               | 2005       |
|  | -----                               | -----      | -----                              | -----      |
| Earnings from continuing operations .....                  | \$ 2,583                            | \$ 4,163   | \$ 10,636                          | \$ 3,935   |
| Income (loss) from discontinued operations .....           | 1,656                               | (449)      | 603                                | (1,240)    |
|  | -----                               | -----      | -----                              | -----      |
| Net earnings available to common stockholders .....        | \$ 4,239                            | \$ 3,714   | \$ 11,239                          | \$ 2,695   |
|  | =====                               | =====      | =====                              | =====      |
| Weighted average common shares outstanding - basic .....   | 18,306,178                          | 19,547,319 | 18,265,784                         | 19,509,040 |
| Dilutive effect of restricted stock ...                    | 64,998                              | --         | 32,195                             | --         |
| Dilutive effect of options .....                           | 259                                 | 30,653     | --                                 | 37,221     |
|  | -----                               | -----      | -----                              | -----      |
| Weighted average common shares outstanding - diluted ..... | 18,371,435                          | 19,577,972 | 18,297,979                         | 19,546,261 |
|  | =====                               | =====      | =====                              | =====      |

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per share because to do so would have been anti-dilutive for the periods presented.

|                             | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-----------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                             | 2006                                | 2005      | 2006                               | 2005      |
| Stock options.....          | 1,059,311                           | 1,233,348 | 1,059,311                          | 1,226,780 |
| Convertible debentures..... | 2,796,120                           | 2,796,120 | 2,796,120                          | 2,796,120 |

### NOTE 9. EMPLOYEE BENEFITS

In 2000, we created an employee benefits trust to which we contributed 750,000 shares of treasury stock. We are authorized to instruct the trustees to distribute such shares toward the satisfaction of our future obligations under employee benefit plans. The shares held in trust are not considered outstanding for purposes of calculating earnings per share until they are committed to be released. The trustees will vote the shares in accordance with their fiduciary duties. During the first quarter of 2006, we committed 118,500 shares to be released leaving 182,000 shares remaining in the trust.

In August 1994, we established an unfunded Supplemental Executive Retirement Plan (SERP) for key employees. Under the plan, these employees may elect to defer a portion of their compensation and, in addition, we may at our discretion make contributions to the plan on behalf of the employees. In March 2006, contributions of \$69,000 were made related to calendar year 2005.

In October 2001, we adopted a second unfunded SERP. The SERP is a defined benefit plan pursuant to which we will pay supplemental pension benefits to certain key employees upon retirement based upon the employees' years of service and compensation. We use a January 1 measurement date for this plan.

We provide certain medical and dental care benefits to eligible retired employees. Our current policy is to fund the cost of the health care plans on a pay-as-you-go basis. Effective September 1, 2005, we restricted the eligibility requirements of employees who can participate in this program, whereby all active employees hired after 1995 are no longer eligible to participate. In the three months ended September 30, 2005, in accordance with SFAS No. 106, Employers' Accounting For Post-Retirement Benefits Other Than Pensions, we recognized a curtailment gain of \$3.8 million for our post-retirement plan mainly related to the above changes made to our plan. The curtailment accounting required us to recognize at that time a pro-rata portion of the unrecognized prior service cost as a result of the changes.

In December 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "Medicare Reform Act") was signed into law. The Medicare Reform Act expanded Medicare to include, for the first time, coverage for prescription drugs. In connection with the Medicare Reform Act, the FASB issued FASB Staff Position ("FSP") No. FAS 106-2, which provides guidance on accounting for the effects of the new Medicare prescription drug legislation for employers whose prescription drug benefits are actuarially equivalent to the drug benefit under Medicare Part D and are therefore entitled to receive subsidies from the federal government beginning in 2006. On January 21, 2005, the Centers for Medicare and Medicaid Services released final regulations implementing major provisions of the Medicare Reform Act. The regulations address key concepts, such as defining a plan, as well as the actuarial equivalence test for purposes of obtaining a government subsidy. Pursuant to the guidance in FSP No. FAS 106-2, we have

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assessed the financial impact of the regulations and concluded that our post-retirement benefit plan will be qualified for the direct subsidies and, consequently, our accumulated post-retirement benefit obligation decreased by \$6.7 million.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-(CONTINUED)

As a result of the reduced eligibility and Medicare subsidy explained above, we are benefiting in 2006 from a reduction to our post-retirement benefit costs through negative amortization of prior service costs.

The components of net period benefit cost for the three months ended September 30 of our North America and UK defined benefit plans are as follows (in thousands):

|   | Pension Benefits |        | Postretirement Benefits |            |
|---|------------------|--------|-------------------------|------------|
|   | 2006             | 2005   | 2006                    | 2005       |
| Service cost .....                              | \$ 99            | \$ 130 | \$ 200                  | \$1,078    |
| Interest cost .....                             | 100              | 131    | 581                     | 776        |
| Amortization of transition obligation .....     | --               | --     | 1                       | --         |
| Amortization of prior service cost (credit) ... | 28               | 40     | (713)                   | 123        |
| Actuarial net (gain) loss .....                 | (16)             | 4      | 480                     | 1          |
| SFAS 106 curtailment gain .....                 | --               | --     | --                      | (3,842)    |
|   | -----            | -----  | -----                   | -----      |
| Net periodic benefit (benefit) cost .....       | \$ 211           | \$ 305 | \$ 549                  | \$ (1,864) |

The components of net period benefit cost for the nine months ended September 30 of our North America and UK defined benefit plans are as follows (in thousands):

|   | Pension Benefits |        | Postretirement Benefits |         |
|---|------------------|--------|-------------------------|---------|
|   | 2006             | 2005   | 2006                    | 2005    |
| Service cost .....                              | \$ 296           | \$ 390 | \$ 604                  | \$2,714 |
| Interest cost .....                             | 301              | 393    | 1,536                   | 1,854   |
| Amortization of transition obligation .....     | --               | --     | 3                       | --      |
| Amortization of prior service cost (credit) ... | 83               | 120    | (2,140)                 | 185     |
| Actuarial net (gain) loss .....                 | (48)             | 14     | 1,099                   | 3       |
| SFAS 106 curtailment gain .....                 | --               | --     | --                      | (3,842) |
|   | -----            | -----  | -----                   | -----   |
| Net periodic benefit cost .....                 | \$ 632           | \$ 917 | \$1,102                 | \$ 914  |

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### NOTE 10. INDUSTRY SEGMENTS

The following tables show our net sales and operating income by our operating segments (in thousands):

|                          | Three Months Ended September 30, |                            |           |                            |
|--------------------------|----------------------------------|----------------------------|-----------|----------------------------|
|                          | 2006                             |                            | 2005      |                            |
|                          | Net Sales                        | Operating<br>Income (Loss) | Net Sales | Operating<br>Income (Loss) |
| Engine Management .....  | \$127,752                        | \$ 6,958                   | \$135,819 | \$ 2,349                   |
| Temperature Control .... | 59,917                           | 3,986                      | 74,537    | 7,078                      |
| Europe .....             | 12,813                           | 98                         | 11,600    | 250                        |
| All Other .....          | 3,273                            | (2,347)                    | 2,482     | 108                        |
| Consolidated .....       | \$203,755                        | \$ 8,695                   | \$224,438 | \$ 9,785                   |

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - (CONTINUED)

|                          | Nine Months Ended September 30, |                            |           |                            |
|--------------------------|---------------------------------|----------------------------|-----------|----------------------------|
|                          | 2006                            |                            | 2005      |                            |
|                          | Net Sales                       | Operating<br>Income (Loss) | Net Sales | Operating<br>Income (Loss) |
| Engine Management .....  | \$416,462                       | \$ 30,450                  | \$419,855 | \$ 19,478                  |
| Temperature Control .... | 181,289                         | 11,585                     | 195,539   | 8,577                      |
| Europe .....             | 36,191                          | 490                        | 34,679    | (212)                      |
| All Other .....          | 9,063                           | (10,906)                   | 8,203     | (10,896)                   |
| Consolidated .....       | \$643,005                       | \$ 31,619                  | \$658,276 | \$ 16,947                  |

### NOTE 11. COMMITMENTS AND CONTINGENCIES

ASBESTOS. In 1986, we acquired a brake business, which we subsequently sold in March 1998 and which is accounted for as a discontinued operation. When we originally acquired this brake business, we assumed future liabilities relating to any alleged exposure to asbestos-containing products manufactured by the seller of the acquired brake business. In accordance with the related purchase agreement, we agreed to assume the liabilities for all new claims filed on or after September 1, 2001. Our ultimate exposure will depend upon the number of claims filed against us on or after September 1, 2001 and the amounts paid for indemnity and defense thereof. At December 31, 2005 and September 30, 2006, approximately 4,500 cases and 3,300 cases, respectively, were outstanding for which we were responsible for any related liabilities. We believe that the level of new cases will decrease gradually due to recent legislation in certain states mandating minimum medical criteria before a case can be heard. Since inception in September 2001 through September 30, 2006, the amounts paid for settled claims are approximately \$4.9 million. We do not have insurance coverage for the defense and indemnity costs associated with these claims.

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In evaluating our potential asbestos-related liability, we have considered various factors including, among other things, an actuarial study performed by a leading actuarial firm with expertise in assessing asbestos-related liabilities, our settlement amounts and whether there are any co-defendants, the jurisdiction in which lawsuits are filed, and the status and results of settlement discussions. As is our accounting policy, we engage actuarial consultants with experience in assessing asbestos-related liabilities to estimate our potential claim liability. The methodology used to project asbestos-related liabilities and costs in the study considered: (1) historical data available from publicly available studies; (2) an analysis of our recent claims history to estimate likely filing rates into the future; (3) an analysis of our currently pending claims; and (4) an analysis of our settlements to date in order to develop average settlement values. The most recent actuarial study was performed as of August 31, 2006. Based upon all the information considered by the actuarial firm, the actuarial study estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$22.1 million to \$53.9 million for the period through 2050. The change from the prior year study was a \$3.2 million decrease for the low end of the range and a \$2.6 million increase for the high end of the range. Based on the information contained in the actuarial study and all other available information considered by us, we concluded that no amount within the range of settlement payments was more likely than any other and, therefore, recorded the low end of the range as the liability associated with future settlement payments through 2050 in our consolidated financial statements, in accordance with generally accepted accounting principles. Accordingly, a \$3.4 million benefit was recorded to our discontinued operation, and we adjusted our accrued asbestos liability to approximately \$22.1 million. Legal costs, which are expensed as incurred and reported in loss from discontinued operation, are estimated to range from \$11.6 million to \$21.6 million during the same period.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)-(CONTINUED)

We plan to perform an annual actuarial evaluation during the third quarter of each year for the foreseeable future. Given the uncertainties associated with projecting such matters into the future and other factors outside our control, we can give no assurance that additional provisions will not be required. Management will continue to monitor the circumstances surrounding these potential liabilities in determining whether additional provisions may be necessary. At the present time, however, we do not believe that any additional provisions would be reasonably likely to have a material adverse effect on our liquidity or consolidated financial position.

ANTITRUST LITIGATION. On November 30, 2004, we were served with a summons and complaint in the U.S. District Court for the Southern District of New York by The Coalition For A Level Playing Field, which is an organization comprised of a large number of auto parts retailers. The complaint alleges antitrust violations by the Company and a number of other auto parts manufacturers and retailers and seeks injunctive relief and unspecified monetary damages. In August 2005, we filed a motion to dismiss the complaint, following which the plaintiff filed an amended complaint dropping, among other things, all claims under the Sherman Act. The remaining claims allege violations of the Robinson-Patman Act. Motions to dismiss those claims were filed by us in February 2006. Plaintiff has filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments were originally scheduled for September 2006, however the court has adjourned these proceedings until a later date to be determined. Although we cannot predict the ultimate outcome of this case or estimate the range of any

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potential loss that may be incurred in the litigation, we believe that the lawsuit is without merit, deny all of the plaintiff's allegations of wrongdoing and believe we have meritorious defenses to the plaintiff's claims. We intend to defend vigorously this lawsuit.

OTHER LITIGATION. We are involved in various other litigation and product liability matters arising in the ordinary course of business. Although the final outcome of any asbestos-related matters or any other litigation or product liability matter cannot be determined, based on our understanding and evaluation of the relevant facts and circumstances, it is our opinion that the final outcome of these matters will not have a material adverse effect on our business, financial condition or results of operations.

WARRANTIES. We generally warrant our products against certain manufacturing and other defects. These product warranties are provided for specific periods of time of the product depending on the nature of the product. As of September 30, 2006 and 2005, we have accrued \$15.1 million and \$16.8 million, respectively, for estimated product warranty claims included in accrued customer returns. The accrued product warranty costs are based primarily on historical experience of actual warranty claims. Warranty expense for the three months ended September 30, 2006 and 2005 were \$13.7 million and \$15 million, respectively, and \$41.2 million and \$42.1 million for the nine months ended September 30, 2006 and 2005, respectively.

The following table provides the changes in our product warranties (in thousands):

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2006                                | 2005      | 2006                               | 2005      |
|   | -----                               | -----     | -----                              | -----     |
| Balance, beginning of period.....               | \$ 15,391                           | \$ 15,898 | \$ 12,701                          | \$ 13,701 |
| Liabilities accrued for current year sales..... | 13,674                              | 14,952    | 41,211                             | 42,111    |
| Settlements of warranty claims.....             | (13,917)                            | (14,059)  | (38,764)                           | (38,511)  |
|   | -----                               | -----     | -----                              | -----     |
| Balance, end of period.....                     | \$ 15,148                           | \$ 16,791 | \$ 15,148                          | \$ 16,791 |
|   | =====                               | =====     | =====                              | =====     |

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - (CONTINUED)

#### NOTE 12. SUBSEQUENT EVENT

On October 10, 2006, the Company announced plans to close its Puerto Rico manufacturing facility related to our Engine Management Segment following the expiration of the Internal Revenue Code Section 936 benefit and to further our efforts in streamlining costs. We will move these operations to other manufacturing sites of the Company. The facility move and closure is planned to occur in a phased manner over the next 24 months. In connection with this closing, the Company will incur one-time termination benefits to be paid to certain employees at the end of a specified requisite service period. The

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Company estimates these termination benefits will amount to approximately \$2.8 million which will be recognized as expense ratably over the requisite service period. The Company also expects to incur approximately \$3 million in various expenses to move the production assets, close the Puerto Rico facility and relocate some employees. These expenses will be recognized as incurred. No related expenses have been incurred or recognized during the nine months ended September 30, 2006.

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

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS MADE PURSUANT TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995.

FORWARD-LOOKING STATEMENTS IN THIS REPORT ARE INDICATED BY WORDS SUCH AS "ANTICIPATES," "EXPECTS," "BELIEVES," "INTENDS," "PLANS," "ESTIMATES," "PROJECTS" AND SIMILAR EXPRESSIONS. THESE STATEMENTS REPRESENT OUR EXPECTATIONS BASED ON CURRENT INFORMATION AND ASSUMPTIONS AND ARE INHERENTLY SUBJECT TO RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE WHICH ARE ANTICIPATED OR PROJECTED AS A RESULT OF CERTAIN RISKS AND UNCERTAINTIES, INCLUDING, BUT NOT LIMITED TO, ECONOMIC AND MARKET CONDITIONS; THE PERFORMANCE OF THE AFTERMARKET SECTOR; CHANGES IN BUSINESS RELATIONSHIPS WITH OUR MAJOR CUSTOMERS AND IN THE TIMING, SIZE AND CONTINUATION OF OUR CUSTOMERS' PROGRAMS; CHANGES IN THE PRODUCT MIX AND DISTRIBUTION CHANNEL MIX; THE ABILITY OF OUR CUSTOMERS TO ACHIEVE THEIR PROJECTED SALES; COMPETITIVE PRODUCT AND PRICING PRESSURES; INCREASES IN PRODUCTION OR MATERIAL COSTS THAT CANNOT BE RECOUPED IN PRODUCT PRICING; SUCCESSFUL INTEGRATION OF ACQUIRED BUSINESSES; PRODUCT AND ENVIRONMENTAL LIABILITY MATTERS (INCLUDING, WITHOUT LIMITATION, THOSE RELATED TO ASBESTOS-RELATED CONTINGENT LIABILITIES OR ENVIRONMENTAL REMEDIATION LIABILITIES); AS WELL AS OTHER RISKS AND UNCERTAINTIES, SUCH AS THOSE DESCRIBED UNDER RISK FACTORS, QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK AND THOSE DETAILED HEREIN AND FROM TIME TO TIME IN THE FILINGS OF THE COMPANY WITH THE SEC. FORWARD-LOOKING STATEMENTS ARE MADE ONLY AS OF THE DATE HEREOF, AND THE COMPANY UNDERTAKES NO OBLIGATION TO UPDATE OR REVISE THE FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE. IN ADDITION, HISTORICAL INFORMATION SHOULD NOT BE CONSIDERED AS AN INDICATOR OF FUTURE PERFORMANCE. THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, INCLUDING THE NOTES THERETO, INCLUDED ELSEWHERE IN THIS REPORT.

#### BUSINESS OVERVIEW

We are a leading independent manufacturer and distributor of replacement parts for motor vehicles in the automotive aftermarket industry. We are organized into two major operating segments, each of which focuses on a specific segment of replacement parts. Our Engine Management Segment manufactures ignition and emission parts, on-board computers, ignition wires, battery cables and fuel system parts. Our Temperature Control Segment manufactures and remanufactures air conditioning compressors, and other air conditioning and heating parts. We sell our products primarily in the United States, Canada and Latin America. We also sell our products in Europe through our European Segment.

As part of our efforts to grow our business, as well as to achieve increased production and distribution efficiencies, on June 30, 2003 we completed the acquisition of substantially all of the assets and assumed substantially all of the operating liabilities of Dana Corporation's Engine Management Group ("DEM"). Under the terms of the acquisition, we paid Dana Corporation \$93.2 million in cash, issued an unsecured promissory note of \$15.1 million, and issued 1,378,760 shares of our common stock valued at \$15.1 million. Including transaction costs,



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our total purchase price was approximately \$130.5 million. On December 29, 2005, we entered into a Repurchase and Prepayment Agreement with Dana, in which we repurchased the 1,378,760 shares of our common stock at a repurchase price of \$8.63 per share (or an aggregate approximate repurchase price of \$11.9 million) and prepaid at a discount the \$15.1 million unsecured promissory note plus accrued and unpaid interest for an aggregate approximate amount of \$14.5 million. We recognized the discount of \$1 million as a gain on the repayment of the note as well as the unrecognized deferred interest expense thereon of \$0.2 million as income in 2005.

In connection with our acquisition of DEM, we reviewed our operations and implemented integration plans to restructure the operations of DEM. As part of the integration and restructuring plans, we accrued an initial restructuring liability of approximately \$34.7 million at June 30, 2003. Such amounts were recognized as liabilities assumed in the acquisition and included in the allocation of the cost to acquire DEM. Accordingly, such amounts resulted in additional goodwill being recorded in connection with the acquisition. Subsequent to the acquisition, our estimate of the restructuring liability was updated and revised downward at various points in time, with a cumulative reduction to goodwill of \$12.6 million as of September 30, 2006. As of September 30, 2006, the remaining restructuring accrual was \$1.3 million. We expect to pay most of this remaining amount in 2006 and 2007.

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Of the initial restructuring accrual, approximately \$15.7 million related to work force reductions and represented employee termination benefits. The accrual primarily provides for severance costs relating to the involuntary termination of employees, individually employed throughout DEM's facilities across a broad range of functions, including managerial, professional, clerical, manufacturing and factory positions. During the year ended December 31, 2005 and the nine months ended September 30, 2006, termination benefits of \$2.3 million and \$0.1 million, respectively, have been charged to the restructuring accrual. As of September 30, 2006, the reserve balance for workforce reductions was at \$0.7 million.

The initial restructuring accrual also included approximately \$18 million consisting of the net present value of costs associated with exiting certain activities, primarily related to lease and contract termination costs, which will not have future benefits. Specifically, our plans were to consolidate certain of DEM operations into our existing plants. At December 31, 2005, we had a sublease commitment for one facility with Dana through 2021. However, on March 3, 2006, Dana filed a voluntary petition for relief under Chapter 11 of the US Bankruptcy Code. Pursuant to a court ruling in connection with Dana's Chapter 11 bankruptcy proceedings, effective March 31, 2006, we were released from, and no longer have any obligations with respect to, such lease commitment for the facility. We have accounted for the termination of such lease commitment as a reduction of \$10.5 million in our restructuring accrual, with a corresponding reduction to goodwill established on the acquisition of DEM. In addition to the above reduction, exit costs of \$0.8 million were paid as of September 30, 2006, leaving an exit reserve balance of \$0.6 million as of September 30, 2006.

SEASONALITY. Historically, our operating results have fluctuated by quarter, with the greatest sales occurring in the second and third quarters of the year and revenues generally being recognized at the time of shipment. It is in these quarters that demand for our products is typically the highest, specifically in the Temperature Control Segment of our business. In addition to this seasonality, the demand for our Temperature Control products during the second and third quarters of the year may vary significantly with the summer weather and customer inventories. For example, a cool summer may lessen the demand for

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our Temperature Control products, while a hot summer may increase such demand. As a result of this seasonality and variability in demand of our Temperature Control products, our working capital requirements peak near the end of the second quarter, as the inventory build-up of air conditioning products is converted to sales and payments on the receivables associated with such sales have yet to be received. During this period, our working capital requirements are typically funded by borrowing from our revolving credit facility.

The seasonality of our business offers significant operational challenges in our manufacturing and distribution functions. To limit these challenges and to provide a rapid turnaround time of customer orders, we have traditionally offered a pre-season selling program, known as our "Spring Promotion," in which customers are offered a choice of a price discount or longer payment terms.

INVENTORY MANAGEMENT. We face inventory management issues as a result of warranty and overstock returns. Many of our products carry a warranty ranging from a 90-day limited warranty to a lifetime limited warranty, which generally covers defects in materials or workmanship and failure to meet industry published specifications. In addition to warranty returns, we also permit our customers to return products to us within customer-specific limits (which are generally limited to a specified percentage of their annual purchases from us) in the event that they have overstocked their inventories. The Company accrues for overstock returns as a percentage of sales, after giving consideration to recent returns history. In addition, the seasonality of our Temperature Control Segment requires that we increase our inventory during the winter season in preparation of the summer selling season and customers purchasing such inventory have the right to make returns.

In order to better control warranty and overstock return levels, we tightened the rules for authorized warranty returns, placed further restrictions on the amounts customers can return and instituted a program so that our management can better estimate potential future product returns. In addition, we established procedures whereby a warranty will be voided if a customer does not follow a twelve-step warranty return process with respect to certain products.

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DISCOUNTS, ALLOWANCES AND INCENTIVES. In connection with our sales activities, we offer a variety of usual customer discounts, allowances and incentives. First, we offer cash discounts for paying invoices in accordance with the specified discounted terms of the invoice. Second, we offer pricing discounts based on volume and different product lines purchased from us. These discounts are principally in the form of "off-invoice" discounts and are immediately deducted from sales at the time of sale. For those customers that choose to receive a payment on a quarterly basis instead of "off-invoice," we accrue for such payments as the related sales are made and reduce sales accordingly. Finally, rebates and discounts are provided to customers as advertising and sales force allowances, and allowances for warranty and overstock returns are also provided. Management analyzes historical returns, current economic trends, and changes in customer demand when evaluating the adequacy of the sales returns and other allowances. Significant management judgments and estimates must be made and used in connection with establishing the sales returns and other allowances in any accounting period. We account for these discounts and allowances as a reduction to revenues, and record them when sales are recorded.

### INTERIM RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED SEPTEMBER 30, 2006 TO THE THREE MONTHS ENDED SEPTEMBER 30, 2005

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SALES. Consolidated net sales for the three months ended September 30, 2006 were \$203.8 million, a decrease of \$20.7 million, or 9.2%, compared to \$224.4 million in the same period of 2005, mainly due to Temperature Control net sales decreasing \$14.6 million or 19.6% and Engine Management net sales decreasing \$8.1 million or 5.9%. Our European Segment experienced higher sales of \$1.1 million or 9.9%. The decrease in Temperature Control sales was primarily due to reduced demand resulting from a cooler summer than the prior year and reduced consumer discretionary spending due to higher energy costs, as well as competition from low cost foreign imports. The decrease in Engine Management sales was mainly due to reduced demand and higher than average customer returns as customers reduced their inventories.

GROSS MARGINS. Gross margins, as a percentage of consolidated net sales, increased to 24.2% in the third quarter of 2006 compared to 21.9% in the third quarter of 2005 mainly due to Engine Management margin improvements of 4.7 percentage points, partially offset by a 1.7 percentage point decrease in Temperature Control margin. Our European Segment also experienced increased margins of 24.1% in the third quarter of 2006 as compared to 22.5% in the same period of 2005. In the third quarter of 2006, the margins in Engine Management benefited mainly from price increases and improved procurement and manufacturing costs, partially offset by higher customer returns, as compared against inventory write-offs adversely affecting 2005 margins.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative (SG&A) expenses increased by \$0.9 million to \$40 million in the third quarter of 2006, compared to \$39.1 million in the third quarter of 2005. SG&A expenses were slightly higher due to increased general administration and marketing expenses, partially offset by a reduction in distribution costs resulting from lower sales and by a reduction of \$1 million in draft expenses as we terminated our accounts receivable draft program in the fourth quarter of 2005. The increase in general administration expenses was driven by a \$3.8 million SFAS 106 curtailment gain applied against third quarter of 2005 expenses. As a percentage of net sales, SG&A expenses for the third quarter of 2006 increased to 19.7% from 17.4% for the same period in 2005.

RESTRUCTURING EXPENSES. Restructuring expenses, which include restructuring and integration expenses, increased to \$0.6 million in the third quarter of 2006, compared to \$0.2 million in the third quarter of 2005. The 2006 expenses related mostly to severance costs related to the move of our European production operations and the divestiture of a production unit of our Temperature Control Segment. The restructuring expense for the third quarter of 2005 related to the DEM integration which has since been substantially completed.

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OPERATING INCOME. Operating income was \$8.7 million in the third quarter of 2006, compared to \$9.8 million in the third quarter of 2005. Improved gross margins more than offset lower sales. However, SG&A expense increased \$0.9 million as the third quarter of 2005 benefited from a postretirement medical benefit as discussed above. After adjusting for the postretirement medical benefit, operating income increased \$1.4 million period over period.

OTHER INCOME, NET. Other income, net increased \$0.8 million in the third quarter 2006 compared to the same period in 2005, primarily due to higher equity income and exchange gains from the strengthening Canadian dollar.

INTEREST EXPENSE. Interest expense increased by \$0.6 million in the third quarter 2006 compared to the same period in 2005 primarily due to higher interest rates during the period and the elimination of our accounts receivable draft program which increased our borrowing costs. However, while the

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elimination of the accounts receivable draft program contributed to the interest expense increase, it also contributed to the reduction in draft expenses in SG&A expenses, as discussed above.

**INCOME TAX PROVISION.** The income tax provision was \$1.8 million in the third quarter of 2006 compared to \$1.1 million for the same period in 2005. The increase was primarily due to a higher effective rate for the third quarter of 2006 which was 41.3% compared to 21.5% in the third quarter of 2005. The increase in the effective tax rate is primarily due to the December 31, 2005 expiration of Section 936 of the Internal Revenue Code with regard to our Puerto Rico operations which are taxed at the U.S. statutory rate starting in 2006.

Deferred tax assets, net of a valuation allowance of \$26.1 million and deferred tax liabilities of \$17.3 million, were \$40.6 million as of December 31, 2005. Approximately \$110 million of taxable income must be generated in 2006 and subsequent years in order to realize the net deferred tax assets. We believe it is more likely than not that we will be able to generate this level of taxable income within 6 years of December 31, 2005, based on the assumptions that our Puerto Rico affiliate's profits will create US taxable income following the expiration of Section 936 of the Internal Revenue Code and that our US based Engine Management Segment continues to improve as we realize savings from cost reduction efforts and the move of our Puerto Rico operations to the U.S. and Mexico. Also, our US net operating loss carry forwards of \$37.3 million expire between 2021 and 2025, and our alternative minimum tax credit carry forwards of approximately \$6 million have no expiration date. The results of the third quarter of 2006 are generally in line with the aforementioned assumptions. We continue to monitor our trends and weigh these against our recent domestic loss carry forward history. At this time, we have concluded that our current level of valuation allowance of \$26.1 million continues to be appropriate.

**INCOME (LOSS) FROM DISCONTINUED OPERATION.** Income (loss) from discontinued operation, net of tax, reflects legal expenses associated with our asbestos related liability and adjustments thereto based on the information contained in the actuarial study and all other available information considered by us. We recorded \$1.7 million as income and \$0.4 million as a loss from discontinued operation for the third quarter of 2006 and 2005, respectively. The income for the third quarter of 2006 reflects a \$3.4 million pre-tax adjustment to reduce our indemnity liability in line with our most recent actuarial valuation report, partially offset by legal fees incurred in litigation, whereas the loss for the same period of 2005 reflects only legal expenses. As discussed more fully in note 11 in the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

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### COMPARISON OF NINE MONTHS ENDED SEPTEMBER 30, 2006 TO THE NINE MONTHS ENDED SEPTEMBER 30, 2005

**SALES.** Consolidated net sales for the nine months ended September 30, 2006 were \$643 million, a decrease of \$15.3 million, or 2.3%, compared to \$658.3 million in the same period of 2005. The net sales decrease was primarily due to our Temperature Control net sales decreasing by \$14.3 million or 7.3% due to reduced demand resulting from a cooler summer than the prior year and reduced consumer discretionary spending due to higher energy costs, as well as competition from low cost foreign imports. Engine Management net sales also decreased by \$3.4 million due to reduced demand and higher than average customer returns.

**GROSS MARGINS.** Gross margins, as a percentage of consolidated net sales, increased by 2.5 percentage points to 24.8% for the nine months ended September

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30, 2006 from 22.3% in the same period of 2005. The increase was mainly driven by Engine Management gross margin increases to 24.2% from 20.5% of sales for the nine months ended September 30, 2006 and 2005, respectively. The margin increase in our Engine Management Segment was primarily due to price increases implemented near the end of 2005 and in the first quarter of 2006, as well as reduced procurement and manufacturing costs. Temperature Control and Europe margin percentages increased slightly due to improved costs.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.** Selling, general and administrative (SG&A) expenses increased \$1.9 million to \$126.8 million or 19.7% of consolidated net sales for the nine months ended September 30, 2006, compared to \$124.9 million or 19% of consolidated net sales in the same period of 2005. The increase in SG&A expenses was driven mainly by increases in marketing and general and administrative expenses, partially offset by a reduction of \$2.4 million in draft expenses as we terminated our accounts receivable draft program in the fourth quarter of 2005 and a reduction in distribution costs as a result of lower sales. The increase in marketing expenses is due to new catalogue spending, and the increase in general administrative expenses was mainly due to our ongoing efforts to fully integrate our operations into a common enterprise resource planning system.

**RESTRUCTURING EXPENSES.** Restructuring expenses, which include restructuring and integration expenses, decreased to \$0.8 million for the nine months ended September 30, 2006, compared to \$4.6 million for the same period in 2005. The 2006 expenses related mostly to severance costs related to the move of our European production operations and the divestiture of a production unit of our Temperature Control Segment. Expenses for the same period in 2005 were primarily for a non-cash asset impairment charge of \$3.4 million in our Temperature Control business related to a strategic decision to outsource products previously manufactured, while the remainder was mostly related to the DEM integration which has since been substantially completed.

**OPERATING INCOME.** Operating income increased by \$14.7 million to \$31.6 million for the nine months ended September 30, 2006, compared to \$16.9 million in the same period in 2005. The increase was primarily due to higher gross profit from Engine Management's 3.7 point improvement in gross profit percentage, lower integration expenses and the elimination of the accounts receivable draft program fees, partially offset by higher SG&A expenses.

**OTHER INCOME, NET.** Other income, net increased \$0.9 million for the nine months ended September 30, 2006 compared to the same period in 2005, primarily due to higher exchange gains on the strengthening Canadian dollar as well as higher equity income.

**INTEREST EXPENSE.** Interest expense increased by \$2.2 million for the nine months ended September 30, 2006 compared to the same period in 2005 due to higher average borrowings and higher borrowing costs. The increase in average borrowings is due to the termination of our accounts receivable draft program in the fourth quarter of 2005, as well as the funding of the repurchase of our common stock held by Dana for \$11.9 million.

**INCOME TAX PROVISION.** The income tax provision was \$8.1 million for the nine months ended September 30, 2006 compared to \$1.4 million for the same period in 2005. The increase was primarily due to higher pre-tax earnings and a higher effective rate for the nine months ended September 30, 2006 which was 43.3% compared to 26.8% for the same period in 2005. The increase in the effective tax rate is primarily due to the December 31, 2005 expiration of Section 936 of the Internal Revenue Code with regard to our Puerto Rico operations which are taxed at the U.S. statutory rate starting in 2006. Deferred tax assets, net of a valuation allowance of \$26.1 million and deferred tax liabilities of \$17.3 million, were \$40.6 million as of December 31, 2005. As discussed above, we have concluded that our current level of valuation allowance of \$26.1 million

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continues to be appropriate.

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INCOME (LOSS) FROM DISCONTINUED OPERATION. Income (loss) from discontinued operation, net of tax, reflects legal expenses associated with our asbestos related liability and adjustments thereto based on the information contained in the actuarial study and all other available information considered by us. We recorded \$0.6 million as income and \$1.2 million as a loss from discontinued operation for the nine months ended September 30, 2006 and 2005, respectively. The income for the nine months ended September 30, 2006 reflects a \$3.4 million pre-tax adjustment to reduce our indemnity liability in line with our most recent actuarial valuation report, partially offset by legal fees incurred in litigation, whereas the loss for the same period of 2005 reflects only legal expenses. As discussed more fully in note 11 of the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

### LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES. During the first nine months of 2006, cash provided by operations amounted to \$9 million, compared to cash used in operations of \$63.2 million in the same period of 2005. The period over period improvement of \$72.2 million is primarily attributable to a lower increase in accounts receivable of \$54.7 million and an increase in net earnings. The lower increase in accounts receivable was caused partly by a smaller balance in accounts receivable as of September 30, 2006 as compared the balance as of September 30, 2005 due to delays in monetizing the remaining drafts as of September 30, 2005 and by December 2005 levels which were higher than in December 2004 following the termination of our accounts receivable draft program at the end of 2005.

INVESTING ACTIVITIES. Cash used in investing activities was \$7.7 million in the first nine months of 2006, compared to \$5.2 million in the same period of 2005. The increase of \$2.4 million was primarily due to lower proceeds from the sale of property, plant and equipment.

FINANCING ACTIVITIES. Cash used in financing activities was \$2.4 million in the first nine months of 2006, compared to cash provided by financing activities of \$67.4 million in the same period of 2005. The decrease is primarily due to the reduction in borrowings under our line of credit, which was \$62.8 million lower in the nine months ended September 30, 2006 compared to the same period in 2005. We had lower borrowings due to an improvement in cash provided by operating activities and a decrease in our bank overdraft balances.

We are parties to an agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The term of the credit agreement is through 2008 and provides for a line of credit up to \$305 million. Availability under our revolving credit facility is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. After taking into account outstanding borrowings under the revolving credit facility, there was an additional \$68.8 million available for us to borrow pursuant to the formula at September 30, 2006. Our credit agreement also permits dividends and distributions by us provided specific conditions are met.

Direct borrowings under our revolving credit facility bear interest at the prime rate plus the applicable margin (as defined in the credit agreement) or, at our option, the LIBOR rate plus the applicable margin (as defined in the credit agreement). Borrowings are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. The terms of our revolving credit facility provide for,

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among other provisions, financial covenants requiring us, on a consolidated basis: (1) to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months) through 2008; and (2) to limit capital expenditure levels for each fiscal year through 2008. The terms of our revolving credit facility also provide, among other things, for the prohibition of accepting drafts under our customer draft programs after November 18, 2005.

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In December 2005, our Canadian subsidiary entered into a credit agreement with GE Canada Finance Holding Company, for itself and as agent for the lenders, and GECC Capital Markets, Inc., as lead arranger and book runner. The credit agreement provides for, among other things, a \$7 million term loan, which term loan is guaranteed and secured by us and certain of our wholly-owned subsidiaries and which term loan is coterminous with the term of our revolving credit facility. The \$7 million term loan is part of the \$305 million available for borrowing under our revolving credit facility.

In addition, in order to facilitate the aggregate financing of the DEM acquisition in June 2003, we completed a public equity offering of 5,750,000 shares of our common stock for net proceeds of approximately \$55.7 million. We also issued to Dana Corporation 1,378,760 shares of our common stock valued at approximately \$15.1 million and an unsecured subordinated promissory note in the aggregate principal amount of approximately \$15.1 million due December 31, 2008. The promissory note had an interest rate of 9% per annum for the first year, with such interest rate increasing by one-half of a percentage point (0.5%) on each anniversary of the date of issuance. Accrued and unpaid interest was due quarterly under the promissory note. On December 29, 2005, we entered into an agreement with Dana, in which we repurchased the 1,378,760 shares of our common stock at a repurchase price of \$8.63 per share (or an aggregate approximate repurchase price of \$11.9 million) and prepaid at a discount the \$15.1 million unsecured promissory note plus accrued and unpaid interest for an aggregate approximate amount of \$14.5 million.

In June 2003, we borrowed \$10 million under a mortgage loan agreement. The loan is payable in equal monthly installments. The loan bears interest at a fixed rate of 5.50% maturing in July 2018. The mortgage loan is secured by the related building and property.

Our profitability and working capital requirements are seasonal due to the sales mix of temperature control products. Our working capital requirements usually peak near the end of the second quarter, as the inventory build-up of air conditioning products is converted to sales and payments on the receivables associated with such sales begin to be received. These increased working capital requirements are funded by borrowings from our lines of credit. In 2004 and the first quarter of 2005, we also received the benefit from accelerating accounts receivable collections from customer draft programs. However, in the second quarter of 2005 we reduced the early monetizing of these accounts receivable under the draft program. An amendment to our revolving credit facility in November 2005 prohibits us from accepting drafts under our customer draft programs since November 18, 2005. We anticipate that our present sources of funds will continue to be adequate to meet our near term needs.

In October 2003, we entered into an interest rate swap agreement with a notional amount of \$25 million that matured in October 2006. Under this agreement, we received a floating rate based on the LIBOR interest rate, and paid a fixed rate of 2.45% on the notional amount of \$25 million. We have not entered into a new swap agreement to replace this agreement.

In July 1999, we issued convertible debentures, payable semi-annually, in the

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aggregate principal amount of \$90 million. The debentures carry an interest rate of 6.75%, payable semi-annually. The debentures are convertible into 2,796,120 shares of our common stock, and mature on July 15, 2009. The proceeds from the sale of the debentures were used to prepay an 8.6% senior note, reduce short term bank borrowings and repurchase a portion of our common stock.

As of September 30, 2006, we have Board authorization to repurchase additional shares at a maximum cost of \$1.7 million. During 2005 and the first nine months of 2006, other than the repurchase of our common stock held by Dana as discussed above, we did not repurchase any shares of our common stock either in the open market or otherwise.

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The following is a summary of our contractual commitments as of December 31, 2005. Other than as discussed below, there have been no significant changes to this information at September 30, 2006. At December 31, 2005, we were parties to a sublease agreement with Dana Corporation, which agreement was originally scheduled to expire in 2021. However, on March 3, 2006, Dana filed a voluntary petition for relief under Chapter 11 of the US Bankruptcy Code. Pursuant to a court ruling in connection with Dana's Chapter 11 bankruptcy proceedings, effective March 31, 2006, we were released from, and no longer have any obligations with respect to, such lease commitment for the facility. As such, our operating lease commitment in each year for the five year period from 2006 to 2010 has been reduced by \$1.2 million per year and for the period from 2011-2015 has been reduced by \$14.5 million in the aggregate.

The table below in the "Operating leases" line item has been revised to reflect these reductions.

| (IN THOUSANDS)                                  | 2006    | 2007    | 2008    | 2009      | 2010    | 2011-2015 |
|---|---------|---------|---------|-----------|---------|-----------|
| Principal payments of long term debt .....      | \$ 542  | \$ 555  | \$ 512  | \$ 90,530 | \$ 560  | \$ 6,000  |
| Operating leases .....                          | 6,941   | 5,839   | 4,650   | 3,240     | 1,175   | 7,000     |
| Interest rate swap agreements .....             | (496)   | --      | --      | --        | --      | --        |
| Post-employee retirement benefits .....         | 970     | 1,069   | 1,536   | 1,655     | 1,768   | 10,000    |
| Severance payments related to integration ..... | 396     | 413     | --      | --        | --      | --        |
| Total commitments .....                         | \$8,353 | \$7,876 | \$6,698 | \$ 95,425 | \$3,503 | \$ 24,000 |

### CRITICAL ACCOUNTING POLICIES

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations," where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see note 1 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005. You should be aware that preparation of our consolidated quarterly



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financial statements in this Report requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. We can give no assurance that actual results will not differ from those estimates.

**REVENUE RECOGNITION.** We derive our revenue primarily from sales of replacement parts for motor vehicles from both our Engine Management and Temperature Control Segments. We recognize revenues when products are shipped and title has been transferred to a customer, the sales price is fixed and determinable, and collection is reasonably assured. For some of our sales of remanufactured products, we also charge our customers a deposit for the return of a used core component which we can use in our future remanufacturing activities. Such deposit is not recognized as revenue but rather carried as a core liability. The liability is extinguished when a core is eventually returned to us. We estimate and record provisions for cash discounts, quantity rebates, sales returns and warranties in the period the sale is recorded, based upon our prior experience and current trends. As described below, significant management judgments and estimates must be made and used in estimating sales returns and allowances relating to revenue recognized in any accounting period.

**INVENTORY VALUATION.** Inventories are valued at the lower of cost or market. Cost is generally determined on the first-in, first-out basis. Where appropriate, standard cost systems are utilized for purposes of determining cost; the standards are adjusted as necessary to ensure they approximate actual costs. Estimates of lower of cost or market value of inventory are determined at the reporting unit level and are based upon the inventory at that location taken as a whole. These estimates are based upon current economic conditions, historical sales quantities and patterns and, in some cases, the specific risk of loss on specifically identified inventories.

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We also evaluate inventories on a regular basis to identify inventory on hand that may be obsolete or in excess of current and future projected market demand. For inventory deemed to be obsolete, we provide a reserve on the full value of the inventory. Inventory that is in excess of current and projected use is reduced by an allowance to a level that approximates our estimate of future demand.

We utilize cores (used parts) in our remanufacturing processes for air conditioning compressors. The production of air conditioning compressors involves the rebuilding of used cores, which we acquire generally either in outright purchases or from returns pursuant to an exchange program with customers. Under such exchange programs, we reduce our inventory, through a charge to cost of sales, when we sell a finished good compressor, and put back to inventory at standard cost through a credit to cost of sales the used core exchanged at the time it is eventually received from the customer.

**SALES RETURNS AND OTHER ALLOWANCES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS.** Management must make estimates of potential future product returns related to current period product revenue. Management analyzes historical returns, current economic trends, and changes in customer demand when evaluating the adequacy of the sales returns and other allowances. Significant management judgments and estimates must be made and used in connection with establishing the sales returns and other allowances in any accounting period. At September 30, 2006, the allowance for sales returns was \$30.9 million. Similarly, management must make estimates of the uncollectability of our accounts receivable. Management specifically analyzes accounts receivable and historical bad debts, customer

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concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. At September 30, 2006, the allowance for doubtful accounts and for discounts was \$10.1 million.

ACCOUNTING FOR NEW CUSTOMER ACQUISITION COSTS. New customer acquisition costs refer to arrangements pursuant to which we incur change-over costs to induce a new customer to switch from a competitor's brand. In addition, change-over costs include the costs related to removing the new customer's inventory and replacing it with Standard Motor Products inventory commonly referred to as a stocklift. New customer acquisition costs are recorded as a reduction to revenue when incurred.

ACCOUNTING FOR INCOME TAXES. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent we believe that it is more likely than not that the deferred tax assets will not be recovered, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase or decrease this allowance in a period, we must include an expense or recovery, respectively, within the tax provision in the statement of operations.

Significant management judgment is required in determining the adequacy of our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. At September 30, 2006, we had a valuation allowance of \$26.1 million, due to uncertainties related to our ability to utilize some of our deferred tax assets. The assessment of the adequacy of our valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable.

In the event that actual results differ from these estimates, or we adjust these estimates in future periods for current trends or expected changes in our estimating assumptions, we may need to modify the level of valuation allowance which could materially impact our business, financial condition and results of operations.

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VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL. We assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important, which could trigger an impairment review, include the following: (a) significant underperformance relative to expected historical or projected future operating results; (b) significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and (c) significant negative industry or economic trends. With respect to goodwill, if necessary, we test for potential impairment in the fourth quarter of each year as part of our annual budgeting process. We review the fair values of each of our reporting units using the discounted cash flows method and market multiples.

In the event our planning assumptions were modified resulting in impairment to our assets, we would be required to include an expense in our statement of operations, which could materially impact our business, financial condition and

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results of operations.

RETIREMENT AND POST-RETIREMENT MEDICAL BENEFITS. Each year, we calculate the costs of providing retiree benefits under the provisions of SFAS 87, Employers' Accounting for Pensions, and SFAS 106, Employers' Accounting for Post-retirement Benefits Other than Pensions. The key assumptions used in making these calculations are disclosed in notes 13 and 14 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005. The most significant of these assumptions are the eligibility criteria of participants, the discount rate used to value the future obligation, expected return on plan assets and health care cost trend rates. We select discount rates commensurate with current market interest rates on high-quality, fixed-rate debt securities. The expected return on assets is based on our current review of the long-term returns on assets held by the plans, which is influenced by historical averages. The medical cost trend rate is based on our actual medical claims and future projections of medical cost trends. Under FSP No. FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," the Company has concluded that its post-retirement plan is actuarially equivalent to the Medicare Part D benefit and accordingly recognizes subsidies from the federal government in the measurement of the accumulated post-retirement benefit obligation under SFAS 106, "Employers' Accounting for Post-Retirement Benefits Other Than Pensions". In addition, in accordance with SFAS No. 106, Employers' Accounting For Post-Retirement Benefits Other Than Pensions, in September 2005 we recognized a curtailment gain of \$3.8 million for our post-retirement plan related to changes made to our plan, namely reducing the number of participants eligible for our plan by making all active participants hired after 1995 no longer eligible.

ASBESTOS RESERVE. We are responsible for certain future liabilities relating to alleged exposure to asbestos-containing products. In accordance with our accounting policy, our most recent actuarial study estimated a liability for settlement payments, excluding legal costs, ranging from \$22.1 million to \$53.9 million. Based on the information contained in the actuarial study and all other available information considered by us, we concluded that no amount within the range of settlement payments was more likely than any other and, therefore, recorded the low end of the range as the liability associated with future settlement payments through 2050 in our consolidated financial statements, in accordance with generally accepted accounting principles. Legal costs, which are expensed as incurred and reported in loss from discontinued operation, are estimated to range from \$11.6 million to \$21.6 million during the same period. We plan to perform an annual actuarial analysis during the third quarter of each year for the foreseeable future. Based on this analysis and all other available information, we will continue to reassess the recorded liability and, if deemed necessary, record an adjustment to the reserve, which will be reflected as a loss or gain from discontinued operation.

OTHER LOSS RESERVES. We have numerous other loss exposures, such as environmental claims, product liability and litigation. Establishing loss reserves for these matters requires the use of estimates and judgment of risk exposure and ultimate liability. We estimate losses using consistent and appropriate methods; however, changes to our assumptions could materially affect our recorded liabilities for loss.

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RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS.

SHARE-BASED PAYMENT

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In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). SFAS 123R requires that stock-based employee compensation be recorded as a charge to earnings. SFAS 123R is effective for interim and annual financial statements for years beginning after December 15, 2005 and applies to all outstanding and unvested share-based payments at the time of adoption. Accordingly, we have adopted SFAS 123R commencing January 1, 2006 using a modified prospective application, as permitted by SFAS 123R. Accordingly, prior period amounts have not been restated. Under this application, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Prior to the adoption of SFAS 123R, we applied Accounting Principles Board Opinions ("APB") No. 25 and related interpretations to account for our stock plans resulting in the use of the intrinsic value to value the stock. Under APB 25, we were not required to recognize compensation expense for the cost of stock options. In accordance with the adoption of SFAS 123R, we recorded stock-based compensation expense for the cost of incentive stock options, restricted stock and performance-based stock granted under our stock plans. Stock-based compensation expense for the third quarter of 2006 was \$149,100 (\$91,600 net of tax) or \$0.01 per basic and diluted share and \$559,500 (\$343,800 net of tax) or \$0.02 per basic and diluted share for the nine months ended September 30, 2006. The adoption of SFAS 123R did not have a material impact on our financial position, results of operation or cash flows.

### ACCOUNTING FOR UNCERTAIN TAX POSITIONS

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Only tax positions meeting the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of this Interpretation. FIN 48 also provides guidance on accounting for derecognition, interest and penalties, and classification and disclosure of matters related to uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006 and, as a result, is effective for our Company beginning January 1, 2007. FIN 48 will require adjustment to the opening balance of retained earnings (or other components of shareholders' equity in the statement of financial position) for the cumulative effect of the difference in the net amount of assets and liabilities for all open tax positions at the effective date. Management is currently assessing the impact, if any, which the adoption of FIN 48 will have on our consolidated financial position, results of operations and cash flows.

### FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS 157 is effective for the fiscal year beginning after November 15, 2007, which for the Company is the year ending December 31, 2007. Management is currently assessing the impact, if any, which the adoption of SFAS 157 will have on our consolidated financial position, results of operations and cash flows.

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### ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit pension or postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through accumulated other comprehensive income in shareholders' equity. This statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. The Company will be required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006, which for the Company will be the year ending December 31, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008, or for the Company's year ending December 31, 2008. Management estimates the impact of adopting SFAS 158 will not result in a material change to its total liabilities or shareholders' equity.

### QUANTIFYING MISSTATEMENTS IN CURRENT YEAR FINANCIAL STATEMENTS

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 provides interpretive guidance on how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in the current year financial statements. SAB 108 requires registrants to quantify misstatements using both an income statement ("rollover") and balance sheet ("iron curtain") approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. If prior years are not restated, the cumulative effect adjustment is recorded in opening accumulated earnings (deficit) as of the beginning of the fiscal year of adoption. SAB 108 is effective for fiscal years ending on or after November 15, 2006, which for the Company is the year ending December 31, 2006. Management is currently assessing the impact, if any, which the adoption of SAB 108 will have on our consolidated financial position, results of operations and cash flows.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk, primarily related to foreign currency exchange and interest rates. These exposures are actively monitored by management. Our exposure to foreign exchange rate risk is due to certain costs, revenues and borrowings being denominated in currencies other than one of our subsidiary's functional currency. Similarly, we are exposed to market risk as the result of changes in interest rates, which may affect the cost of our financing. It is our policy and practice to use derivative financial instruments only to the extent necessary to manage exposures. We do not hold or issue derivative financial instruments for trading or speculative purposes.

We have exchange rate exposure, primarily, with respect to the Canadian dollar, the British pound, the Euro, the Japanese Yen and the Hong Kong dollar. As of December 31, 2005 and September 30, 2006, our monetary assets and liabilities which are subject to this exposure are immaterial, therefore the potential immediate loss to us that would result from a hypothetical 10% change in foreign currency exchange rates would not be expected to have a material impact on our

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earnings or cash flows. This sensitivity analysis assumes an unfavorable 10% fluctuation in both of the exchange rates affecting both of the foreign currencies in which the indebtedness and the financial instruments described above are denominated and does not take into account the offsetting effect of such a change on our foreign-currency denominated revenues.

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We manage our exposure to interest rate risk through the proportion of fixed rate debt and variable rate debt in our debt portfolio. To manage a portion of our exposure to interest rate changes, we enter into interest rate swap agreements. We invest our excess cash in highly liquid short-term investments. Our percentage of variable rate debt to total debt was 60% at December 31, 2005 and 61.5% at September 30, 2006.

Other than the aforementioned, there have been no significant changes to the information presented in Item 7A (Market Risk) of our Annual Report on Form 10-K for the year ended December 31, 2005.

### ITEM 4. CONTROLS AND PROCEDURES

#### (a) Evaluation of Disclosure Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Exchange Act, as of the end of the period covered by this Report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Report.

#### (b) Changes in Internal Control Over Financial Reporting.

During the quarter ended September 30, 2006, we have not made any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

We continue to review, document and test our internal control over financial reporting, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business. These efforts will lead to various changes in our internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In 1986, we acquired a brake business, which we subsequently sold in March 1998 and which is accounted for as a discontinued operation. When we originally acquired this brake business, we assumed future liabilities relating to any

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alleged exposure to asbestos-containing products manufactured by the seller of the acquired brake business. In accordance with the related purchase agreement, we agreed to assume the liabilities for all new claims filed on or after September 1, 2001. Our ultimate exposure will depend upon the number of claims filed against us on or after September 1, 2001 and the amounts paid for indemnity and defense thereof. At December 31, 2001, 2005 and September 30, 2006 approximately 4,500 cases and 3,300 cases, respectively, were outstanding for which we were responsible for any related liabilities. We believe that the level of new cases will decrease gradually due to recent legislation in certain states mandating minimum medical criteria before a case can be heard. Since inception in September 2001 through September 30, 2006, the amounts paid for settled claims are approximately \$4.9 million. We do not have insurance coverage for the defense and indemnity costs associated with these claims.

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On November 30, 2004, we were served with a summons and complaint in the U.S. District Court for the Southern District of New York by The Coalition For A Level Playing Field, which is an organization comprised of a large number of auto parts retailers. The complaint alleges antitrust violations by the Company and a number of other auto parts manufacturers and retailers and seeks injunctive relief and unspecified monetary damages. In August 2005, we filed a motion to dismiss the complaint, following which the plaintiff filed an amended complaint dropping, among other things, all claims under the Sherman Act. The remaining claims allege violations of the Robinson-Patman Act. Motions to dismiss those claims were filed by us in February 2006. Plaintiff has filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments were originally scheduled for September 2006, however the court has adjourned these proceedings until a later date to be determined. Although we cannot predict the ultimate outcome of this case or estimate the range of any potential loss that may be incurred in the litigation, we believe that the lawsuit is without merit, deny all of the plaintiff's allegations of wrongdoing and believe we have meritorious defenses to the plaintiff's claims. We intend to defend vigorously this lawsuit.

We are involved in various other litigation and product liability matters arising in the ordinary course of business. Although the final outcome of any asbestos-related matters or any other litigation or product liability matter cannot be determined, based on our understanding and evaluation of the relevant facts and circumstances, it is our opinion that the final outcome of these matters will not have a material adverse effect on our business, financial condition or results of operations.

### ITEM 6. EXHIBITS

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

STANDARD MOTOR PRODUCTS, INC.  
(Registrant)

Date: November 9, 2006

/s/ James J. Burke  
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James J. Burke  
Vice President Finance,  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

/s/ Luc Gregoire  
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Luc Gregoire  
Corporate Controller and  
Chief Accounting Officer

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STANDARD MOTOR PRODUCTS, INC.

EXHIBIT INDEX

EXHIBIT  
NUMBER  
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