



2 0 0 6   A N N U A L   R E P O R T

**STANDARD**<sup>®</sup>  
Standard Motor Products, Inc

**STANDARD**<sup>®</sup>  
Engine Performance Specialists



**BWD**



### Registrar and Transfer Agent

Registrar & Transfer Co.  
10 Commerce Drive  
Cranford, NJ 07016

### Common Stock

Standard Motor Products, Inc.'s  
Common Stock is listed on the  
New York Stock Exchange  
under the symbol SMP

### Independent Auditors

Grant Thornton LLP  
The Chrysler Center  
666 Third Avenue  
New York, NY 10017

### Executive Offices

Standard Motor Products, Inc.  
37-18 Northern Boulevard  
Long Island City, NY 11101

### Engine Management Segment

Offices: Long Island City, NY  
Manufacturing and Distribution Centers:

- Orlando, FL
- Mishawaka, IN
- Edwardsville, KS
- Independence, KS
- Wilson, NC
- Reno, NV
- Long Island City, NY
- Greenville, SC
- Disputanta, VA
- Hong Kong, China
- Reynosa, Mexico
- Fajardo, Puerto Rico

### Temperature Control Segment

Offices: Lewisville, TX  
Manufacturing and Distribution Centers:

- Corona, CA
- Grapevine, TX
- Fort Worth, TX
- Lewisville, TX
- St. Thomas, Canada
- Reynosa, Mexico

### Europe Segment

- Nottingham, England
- Wellingborough, England
- Bialystok, Poland

### Canada Subsidiary

SMP Motor Products Ltd.  
Mississauga, Ontario

### Hong Kong Subsidiary

Standard Motor Products  
(Hong Kong) Limited  
Hong Kong, China

### Mexico Subsidiary

Standard Motor Products  
Mexico, S. De R.L. De C.V.  
Reynosa, Mexico

### Puerto Rico Subsidiary

Stanric, Inc.  
Fajardo, Puerto Rico

### United Kingdom Subsidiary

Standard Motor Products  
Holdings Limited  
Nottingham, England

# FINANCIAL SUMMARY

## Year Ended December 31,

(Dollars in thousands, except per share amounts)	2006	2005	2004
Net Sales	\$ 812,024	\$ 830,413	824,283
Operating Income (Loss)	35,315	14,082	(1,737)
Earnings (Loss) From Continuing Operations	9,163	(1,770)	(8,907)
Net Earnings (Loss)	\$ 9,411	\$ (3,545)	\$ (14,380)
<b>Per Share:</b>			
Earnings (Loss) From Continuing Operations - Diluted	\$ 0.50	\$ (0.09)	(0.46)
Net Earnings (Loss) - Diluted	0.51	(0.18)	(0.74)
Dividends	0.36	0.36	0.36
Stock Price at Year End	\$ 14.98	\$ 9.23	\$ 15.80
Average Number of Common and Dilutive Shares	18,325,175	19,507,818	19,331,358
Assets	\$ 640,092	\$ 653,044	\$ 656,569
Stockholders' Equity	\$ 190,699	\$ 185,707	\$ 207,312
Total Debt to Capitalization	55.5%	57.2%	52.0%

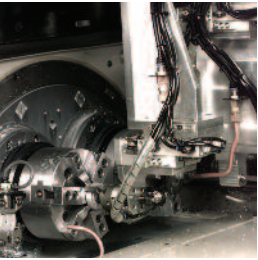
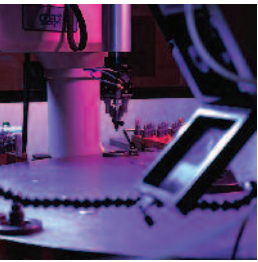
## About the Company

Standard Motor Products, Inc. supplies functional replacement parts for the aftermarket for the engine management and temperature control systems of cars, trucks, buses and tractors. The Company services all makes and models, both new and older cars, imported and domestic. These products are sold primarily in the United States, Canada, Europe, Latin America and in many other countries. The Company employs approximately 4,000 people at its factories and distribution centers in North America, Europe and Hong Kong.

## Annual Stockholders' Meeting

The Standard Motor Products, Inc. Annual Meeting of Stockholders will be held on Thursday, May 17, 2007 at 2:00 PM at JPMorgan Chase, One Chase Manhattan Plaza, New York, NY 10081. A notice of this meeting, together with a proxy statement, is being mailed to all stockholders on or about April 17, 2007.

## T O U R S T O C K H O L D E R S



We are pleased with the progress we made in 2006, as our final results showed a nice improvement over the last few years. Net earnings improved approximately \$13 million from a loss of \$3.5 million in 2005 to a net profit of \$9.4 million in 2006. But we still have a way to go to achieve our goals.

The biggest improvement was in Engine Management, where we are now beginning to reap the benefits of the Dana integration. Our people have labored long and hard over the past three years to fully integrate these two companies. The task is now essentially done.

The biggest single improvement was in Engine Management gross margin, which went from 20.1% in 2005 to 24.6% in 2006, an increase in dollars of \$23.6 million. The biggest single reason for the improvement was that the one-time costs of Dana integration are now behind us. Other factors include improved pricing; increased manufacturing of previously purchased products; and resourcing of other products to low cost areas, mostly in the Far East.

However, to put it in perspective, we are still below our historical Engine Management gross margin levels of 27-28%, and continue to work towards that goal.

Temperature Control sales were \$18 million below 2005 for two reasons. First, 2005 was one of the hottest years on record, so the comparisons were difficult. Second, we began to see sales erosion from low cost products imported from China and the Far East.

Our Four Seasons people worked aggressively to reduce costs, so that despite the lower sales, our operating profit was only slightly below 2005. Further, we are in the process of relocating our compressor rebuilding plant to Reynosa, Mexico. Our goal will be to sell a rebuilt compressor, profitably, at 30% below a new unit from China. We believe that we can do this with products rebuilt in Mexico.

Our European division has undergone a major turnaround. We relocated all Engine Management manufacturing from the U.K. to lower cost areas. We opened a new factory in Poland, which has the dual benefit of competitive wages and highly skilled people. And we sold off a substantial portion of our Temperature Control division, which we felt did not fit into our long term plans. The result is a smaller and more profitable business, which we feel is well situated for the future.



We also accomplished some things which were not reflected in the 2006 numbers, but will benefit us in the future. We refinanced our existing bank credit facility with a line of credit up to \$275 million, and an additional \$50 million accordion feature for future expansion needs. The combination of favorable capital markets and our improved financial performance allowed us the opportunity to secure a new five-year term, at reduced borrowing costs and more favorable operating terms. In 2006 we generated almost \$34 million positive cash flow from operating activities.

Next we are becoming more active in China and the Far East. We now have a permanent office operating out of Shanghai, and during 2006 we established an international business development office in Long Island City. Creating a strong presence in China will be a major part of our future development.

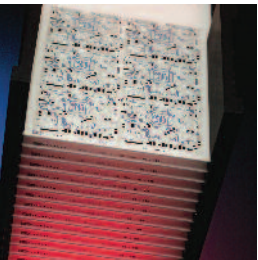
Third, we announced our intention to close two of our longest running manufacturing operations in Puerto Rico and Long Island City. Puerto Rico, once the 936 tax benefit was eliminated, became a very costly place to do business. And our Long Island City plastic molding operation, which was one of the last factories of any kind still operating in New York City, is falling victim to the increased trend towards globalization.

These were extremely difficult decisions. These two factories have been operating successfully for many years and are staffed with hard working, loyal, and skillful people. But in the end, we felt we had no choice. Most of the output of these two factories will be shifted to Reynosa, Mexico and the balance to our existing facility in Independence, Kansas. The process will be complete by the end of 2008. The one-time costs of the moves will be approximately \$9 million with an annual savings forecast at \$9 million once the transition is completed.

Finally, we are beginning to achieve some success in our OES/OEM (Original Equipment Service/Original Equipment Manufacturing) business. We received new firm orders, of about \$25 million annually, and we will begin shipping during the second half of 2007. We see this area as having significant potential for the future. It is profitable; it adds many hours to our factories; we gain technical information from the OE's; and we gain credibility with our aftermarket customers.



▲  
*From Left to Right: Lawrence I. Sills, Chairman of the Board and CEO; James J. Burke, Vice President Finance and Chief Financial Officer; and John P. Gethin, President and Chief Operating Officer.*



To conclude, we realize that both we and our industry are facing significant challenges: the original parts are made better, reducing the replacement rate; we have low priced parts coming in from China and the Far East; we sell to fewer and more demanding customers. However, because of all the steps we have taken, and are continuing to take, we believe we are in a good position to meet these challenges.

Before closing, we wish to publicly acknowledge Mr. Kenneth A. Lehman, one of our senior Board members, who has chosen to retire after serving almost eight years on the Board. We will certainly miss his dedication, intelligence, and knowledge of the industry, and we wish him the best for the future.

### *CEO and CFO Certifications*

*In 2006 Standard Motor Products' chief executive officer (CEO) provided to the New York Stock Exchange the annual CEO certification regarding Standard's compliance with the New York Stock Exchange's corporate governance listing standards. In addition, Standard's CEO and chief financial officer filed with the U.S. Securities and Exchange Commission all required certifications regarding the quality of Standard's public disclosures in its fiscal 2006 reports.*

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549.**  
**FORM 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2006**

**or**

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

**For the transaction period from \_\_\_\_ to \_\_\_\_**

**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)

**Registrant's telephone number, including area code:**

**(718) 392-0200**

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

Title of each class

Common Stock, par value \$2.00 per share

Name of each exchange on which registered

New York Stock Exchange

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

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 Act). Yes  No

The aggregate market value of the voting common stock based on the closing price on the New York Stock Exchange on June 30, 2006 (the last business day of registrant's most recently completed second fiscal quarter) of \$8.34 per share held by non-affiliates of the registrant was \$127,467,075. For purposes of the foregoing calculation only, all directors and officers have been deemed to be affiliates, but the registrant disclaims that any of such are affiliates.

As of February 28, 2007, there were 18,679,884 outstanding shares of the registrant's common stock, par value \$2.00 per share.

**DOCUMENTS INCORPORATED BY REFERENCE**

The information required by Part III of this Report is incorporated herein by reference from the registrant's definitive proxy statement relating to its annual meeting of stockholders to be held on May 17, 2007.





# STANDARD MOTOR PRODUCTS, INC.

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## PART I

*In this Annual Report on Form 10-K, “Standard Motor Products,” “we,” “us,” “our” and the “Company” refer to Standard Motor Products, Inc. and its subsidiaries, unless the context requires otherwise. 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 liability matters (including, without limitation, those related to asbestos-related contingent 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.*

### ITEM 1. 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 line 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 to warehouse distributors and large retail chains in the United States, Canada and Latin America. We also sell our products in Europe through our European Segment. Our customers consist of many of the leading warehouse distributors, such as CARQUEST and NAPA Auto Parts, as well as many of the leading auto parts retail chains, such as Advance Auto Parts, AutoZone, CSK Auto, O’Reilly Automotive and Pep Boys. Our customers also include national program distribution groups, specialty market distributors and original equipment (OE) service parts organizations. We distribute parts under our own brand names, such as Standard, Blue Streak, BWD, Niehoff, Hayden and Four Seasons, and through private labels, such as CARQUEST and NAPA Auto Parts.

#### Business Strategy

Our goal is to grow revenues and earnings and deliver returns in excess of our cost of capital by providing high quality, low cost replacement parts in the engine management and temperature control automotive aftermarkets. The key elements of our strategy are as follows:

- **Maintain Our Strong Competitive Position in the Engine Management and Temperature Control Businesses.** We are one of the leading independent manufacturers serving North America and other geographic areas in our core businesses of Engine Management and Temperature Control. We believe that our success is attributable to our emphasis on product quality, the breadth and depth of our product lines for both domestic and imported automobiles,

and our reputation for outstanding customer service, as measured by rapid order turn-around times and high-order fill rates.

To maintain our strong competitive position in our markets, we remain committed to the following:

- providing our customers with broad lines of high quality engine management and temperature control products, supported by the highest level of customer service and reliability;
  - continuing to maximize our production and distribution efficiencies;
  - continuing to improve our cost position; and
  - further focusing our engineering development efforts.
- **Provide Superior Customer Service, Product Availability and Technical Support.** Our goal is to increase sales to existing and new customers by leveraging our skills in rapidly filling orders, maintaining high levels of product availability and providing technical support in a cost-effective manner. In addition, our technically skilled sales force professionals provide product selection and application support to our customers.
  - **Evolve and Expand Our Product Lines.** We intend to increase our sales by continuing to develop and expand the range of Engine Management and Temperature Control products that we offer to our customers. We are committed to investing the resources necessary to maintain and expand our technical capability to manufacture multiple product lines that incorporate the latest technologies.
  - **Broaden Our Customer Base.** Our goal is to increase our business by marketing our products more broadly to the distribution businesses of OEMs who sell products to new car dealer service areas.
  - **Improve Operating Efficiency and Cost Position.** Our management places significant emphasis on improving our financial performance by achieving operating efficiencies and improving asset utilization, while maintaining product quality and high customer order fill rates. We intend to continue to improve our operating efficiency and cost position by:
    - increasing cost-effective vertical integration in key product lines through internal development;
    - focusing on integrated supply chain management;
    - maintaining and improving our cost effectiveness and competitive responsiveness to better serve the automotive aftermarket customer base, including sourcing certain products from low cost countries such as those in Asia.
    - adopting company-wide programs geared toward manufacturing and distribution efficiency; and
    - focusing on company-wide overhead and operating expense cost reduction programs, such as closing excess facilities and consolidating redundant functions.
  - **Cash Utilization.** We intend to apply any excess cash flow from operations and the management of working capital to reduce our outstanding indebtedness, pay dividends and repurchase our stock.

## **The Automotive Aftermarket**

The automotive aftermarket industry is comprised of a large number of diverse manufacturers varying in product specialization and size. In addition to manufacturing, aftermarket companies allocate resources towards an efficient distribution process and product engineering in order to maintain the flexibility and responsiveness on which their customers depend. Aftermarket manufacturers must be efficient producers of small lot sizes and do not have to provide systems engineering support. Aftermarket manufacturers also must distribute, with rapid turnaround times, products for a full range of vehicles on the road. The primary customers of the automotive aftermarket manufacturers are national and regional warehouse distributors, large retail chains, automotive repair chains and the dealer service networks of OEMs.

During periods of economic decline or weakness, more automobile owners may choose to repair their current automobiles using replacement parts rather than purchasing new automobiles, which benefit the automotive aftermarket industry, including suppliers like us. The automotive aftermarket industry is also dependent on new car sales, although to a lesser degree than OEMs and their suppliers, because these sales create the total number of cars available for repair. Aggressive financing programs by automakers have increased demand for new cars and trucks, which should benefit the automotive aftermarket manufacturers in the long term as vehicles age.

The automotive aftermarket industry differs substantially from the OEM supply business. Unlike the OEM supply business that primarily follows trends in new car production, the automotive aftermarket industry's performance primarily tends to follow different trends, such as:

- growth in number of vehicles on the road;
- increase in average vehicle age;
- increase in total miles driven per year;
- new and modified environmental regulations;
- increase in pricing of new cars; and
- new car quality and related warranties.

Traditionally, the parts manufacturers of OEMs and the independent manufacturers who supply the original equipment (OE) part applications have supplied a majority of the business to new car dealer networks. However, certain parts manufacturers have become more independent and are no longer affiliated with OEMs, which may provide future opportunities for us to supply replacement parts to the dealer service networks of the OEMs, both for warranty and out-of-warranty repairs.



## Financial Information about our Operating Segments

The table below shows our consolidated net sales by operating segment and by major product group within each segment for the three years ended December 31, 2006. Our three reportable operating segments are Engine Management, Temperature Control and Europe.

	2006		2005		2004	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
(Dollars in thousands)						
<b>Engine Management:</b>						
Ignition and Emission						
Parts .....	\$ 436,238	53.7%	\$455,125	54.8%	\$469,901	57.0%
Wires and Cables .....	106,983	13.2%	91,883	11.1%	92,868	11.3%
<b>Total Engine Management .....</b>	<b>543,221</b>	<b>66.9%</b>	<b>547,008</b>	<b>65.9%</b>	<b>562,769</b>	<b>68.3%</b>
<b>Temperature Control:</b>						
Compressors .....	96,171	11.8%	101,876	12.3%	85,403	10.4%
Other Climate Control						
Parts .....	114,931	14.2%	127,350	15.3%	124,691	15.1%
<b>Total Temperature Control.....</b>	<b>211,102</b>	<b>26.0%</b>	<b>229,226</b>	<b>27.6%</b>	<b>210,094</b>	<b>25.5%</b>
<b>Europe:</b>						
Engine Management Parts .....	30,297	3.7%	26,802	3.2%	25,539	3.1%
Temperature Control Parts.....	16,747	2.1%	16,621	2.0%	15,112	1.8%
<b>Total Europe .....</b>	<b>47,044</b>	<b>5.8%</b>	<b>43,423</b>	<b>5.2%</b>	<b>40,651</b>	<b>4.9%</b>
<b>All Other.....</b>	<b>10,657</b>	<b>1.3%</b>	<b>10,756</b>	<b>1.3%</b>	<b>10,769</b>	<b>1.3%</b>
<b>Total.....</b>	<b>\$ 812,024</b>	<b>100.0%</b>	<b>\$ 830,413</b>	<b>100.0%</b>	<b>\$824,283</b>	<b>100.0%</b>

The following table shows our operating profit and identifiable assets by operating segment for the three years ended December 31, 2006.

	2006		2005		2004	
	Operating Profit	Identifiable Assets	Operating Profit	Identifiable Assets	Operating Profit	Identifiable Assets
(In thousands)						
Engine Management .....	\$ 41,249	\$ 430,158	\$ 19,338	\$ 438,116	\$ 24,549	\$ 429,631
Temperature Control .....	11,954	109,734	11,936	114,441	(2,114)	125,656
Europe .....	46	26,708	(572)	28,217	(2,034)	30,936
All Other.....	(17,934)	73,492	(16,620)	72,270	(22,138)	70,346
<b>Total.....</b>	<b>\$ 35,315</b>	<b>\$ 640,092</b>	<b>\$ 14,082</b>	<b>\$ 653,044</b>	<b>\$ (1,737)</b>	<b>\$ 656,569</b>

“All Other” consists of items pertaining to our corporate headquarters function and our Canadian business unit, each of which does not meet the criteria of a reportable operating segment.

### Engine Management Segment

**Breadth of Products.** We manufacture a full line of engine management replacement parts including distributor caps and rotors, electronic ignition control modules, voltage regulators, coils, switches, sensors, EGR valves and many other engine management components under our brand names Standard, BWD, Niehoff and GP Sorenson and through private labels such as CARQUEST and NAPA. We are a basic manufacturer of many of the engine management parts we market and continue to develop ways of increasing the number of parts we manufacture, rather than purchasing such parts from third parties. In addition, our strategy includes sourcing certain products from low cost countries such as those in Asia. In our Engine Management Segment, replacement parts for ignition and emission control systems accounted for approximately 54%, 55% and 57% of our consolidated net sales in 2006, 2005 and 2004, respectively.

**Computer-Controlled Technology.** Nearly all new vehicles are factory-equipped with computer-controlled engine management systems to control ignition, emission and fuel injection systems. The on-board computers monitor inputs from many types of sensors located throughout the vehicle, and control a myriad of valves, switches and motors to manage engine and vehicle performance. Electronic ignition systems enable the engine to improve fuel efficiency and reduce the level of hazardous fumes in exhaust gases.

In 1992, we entered into a 50/50 joint venture in Canada with Blue Streak Electronics, Inc. to rebuild automotive engine management computers and mass air flow sensors. The volume of products produced by the joint venture is sold primarily to us and has positioned us as a key supplier in the growing remanufactured electronics markets. The Blue Streak joint venture has further expanded its product range to include computers used in temperature control, anti-lock brake systems and air bags, and development of diagnostic repair tools.

We divide our electronic operations between product design and highly automated manufacturing operations in Orlando, Florida and assembly operations, which are performed in assembly plants in Orlando and Hong Kong.

Government emission laws have been implemented throughout the majority of the United States. The Clean Air Act, as amended in 1990, imposes strict emission control test standards on existing and new vehicles, and remains the preeminent legislation in the area of vehicle emissions. As many states have implemented required inspection/maintenance tests, the Environmental Protection Agency, through its rulemaking ability, has also encouraged both manufacturers and drivers to reduce vehicle emissions. As the Clean Air Act was “phased in” beginning in 1994, automobiles must now comply with emission standards from the time they were manufactured, and in most states, until the last day they are in use. We expect that this law and other government emissions laws will have a positive impact on sales of our ignition and emission controls parts since vehicles failing these laws may require repairs utilizing parts sold by us.

Our sales of sensors, valves, solenoids and related parts have increased steadily as automobile manufacturers equip their cars with more complex engine management systems.

**Wire and Cable Products.** Wire and cable parts accounted for approximately 13%, 11% and 11% of our consolidated net sales in 2006, 2005 and 2004, respectively. These products include ignition (spark plug) wires, battery cables and a wide range of electrical wire, terminals, connectors and tools for servicing an automobile’s electrical system.

The largest component of this product line is the sale of ignition wire sets. We have historically offered a premium brand of ignition wires and battery cables, which capitalizes on the market’s awareness of the importance of quality. We have the ability to extrude high voltage wire in Mishawaka, Indiana to be used in our ignition wire sets. This vertical integration of this critical component offers us the ability to achieve lower costs and our own controlled source of supply and quality.

### **Temperature Control Segment**

We manufacture, remanufacture and market a full line of replacement parts for automotive temperature control (air conditioning and heating systems) engine cooling systems, power window accessories and windshield washer systems, primarily under our brand names of Four Seasons, Factory Air, Murray, Hayden, Imperial and Aci and through private labels such as CARQUEST and NAPA. The major product groups sold by our Temperature Control Segment are new and remanufactured compressors, clutch assemblies, blower and radiator fan motors, filter dryers, evaporators, accumulators, hose assemblies, expansion valves, heater valves, AC service tools and chemicals, fan assemblies, fan clutches, engine oil coolers, transmission coolers, window lift motors and windshield washer pumps. Our temperature control

products accounted for approximately 26%, 28% and 26% of our consolidated net sales in 2006, 2005 and 2004, respectively.

Due to increasing offshore competitive price pressure, our Temperature Control business made several changes within its manufacturing portfolio. We have outsourced the manufacturing of several major AC product groups and have implemented plans to consolidate manufacturing facilities. In addition, we have started limited production of remanufactured compressors in Reynosa, Mexico and have entered into several supply agreements for certain products with vendors in low cost countries such as those in Asia.

Today's vehicles are being produced with smaller, more complex and efficient designs. Our Temperature Control Segment continues to be a leader in providing superior training to service dealers who seek the knowledge in which to perform proper repairs for today's vehicles. We believe that our training module (HVAC Tips & Techniques) remains one of the most sought-after training clinics in the industry and among professional service dealers.

## **Europe Segment**

In July 1996, we acquired an equity interest in Standard Motor Products (SMP) Holdings Limited (formerly Intermotor Holdings Limited) located in Nottingham, England. During 2002, we acquired the remaining equity interest bringing the Company's ownership percentage to 100%. SMP Holdings Limited manufactures and distributes a broad line of engine management products primarily to customers in Europe. Also in 1996, we expanded our presence in Europe by opening a European distribution center in Strasbourg, France for temperature control products, which we divested in the fourth quarter of 2006. A joint venture (Blue Streak Europe) between SMP Holdings Limited and Blue Streak Electronics was also initiated in 1996, which joint venture supplies rebuilt engine computers for the European market.

Since 1996, we have made a series of smaller acquisitions supplementing both the Engine Management and Temperature Control portions of our business. With respect to the engine management business, in January 1999 we acquired Webcon UK Limited, an assembler and distributor of fuel system components, which we subsequently divested in June 2003. In January 1999, Blue Streak Europe acquired Injection Correction UK LTD, a subsidiary of Webcon, and in September 2001, acquired TRW Inc.'s electronic control unit remanufacturing division. In April 1999, we acquired Lemark Auto Accessories, a supplier of wire sets. In April 2002, the wire business was further expanded by acquiring Carol Cable Limited, a manufacturer and distributor of wire. In April 2006, we acquired substantially all of the assets of Biazet EI's ignition and coil business in Poland. Subsequently, we relocated certain of our UK manufacturing operations to our facility in Poland.

With respect to the temperature control portion of our business, following the opening of the distribution center in France, in 1997 a joint venture was entered into with Valeo SA to remanufacture air conditioner compressors for the European market. In addition, in January 2000 we acquired Four Seasons UK Ltd. (formerly Vehicle Air Conditioning Parts Ltd.), a distributor of components for the repair of air conditioning systems. In July 2000, the Temperature Control business was further expanded by purchasing Four Seasons Italy SRL (formerly Automotive Heater Exchange SRL) in Italy. In 2001 we entered into a joint venture with Pedro Sanz in Madrid, Spain to distribute our products in the Iberian Peninsula. In the fourth quarter of 2006, we sold a majority portion of our European Temperature Control business, consisting of our equity interests of our operations in Spain and our businesses in France and Italy. The proceeds from the divestiture were \$3.1 million, and we incurred a loss on divestiture of \$3.2 million in the fourth quarter of 2006.

Our European Segment accounted for approximately 6%, 5% and 5% of our consolidated net sales in 2006, 2005 and 2004, respectively. Aftermarket margins are under pressure, while volumes are in a general decline in the ignition and carburetor product lines. We have responded to the adverse market conditions by reducing manufacturing costs through consolidating certain facilities and outsourcing products. In addition, in the fourth quarter of 2004 we entered into an agreement to supply Lucas branded

engine management products into the United Kingdom, which arrangement helped to increase our sales in 2005 and 2006.

### Financial Information about Our Foreign and Domestic Operations and Export Sales

We sell our line of products primarily in the United States, with additional sales in Canada, Europe and Latin America. Our sales are substantially denominated in U.S. dollars.

The table below shows our consolidated net sales by geographic area for the three years ended December 31, 2006.

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
United States .....	\$ 688,030	\$ 716,358	\$ 714,955
Canada .....	48,537	46,353	45,115
Europe .....	47,044	43,423	40,651
Other International .....	28,413	24,279	23,562
Total .....	<u>\$ 812,024</u>	<u>\$ 830,413</u>	<u>\$ 824,283</u>

The table below shows our long-lived assets by geographical area for the three years ended December 31, 2006.

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
United States .....	\$ 144,208	\$ 161,451	\$ 174,056
Europe .....	4,821	4,682	6,214
Canada .....	4,014	3,900	4,144
Other International .....	778	754	785
Total .....	<u>\$ 153,821</u>	<u>\$ 170,787</u>	<u>\$ 185,199</u>

### Sales and Distribution

Over the last ten years, there has been a trend toward consolidation in the distribution chain among warehouse distributors, retailers and auto parts jobbers. In the traditional distribution channel, where we sell our products to warehouse distributors, such distributors supply auto parts jobbers, who in turn sell to professional technicians and to consumers who perform automotive repairs themselves. In recent years, warehouse distributors have been consolidating with other distributors, and an increasing number of distributors own their jobbers. In the retail distribution channel, customers buy directly from us and sell directly to technicians and “do it yourselves.” Retailers are also consolidating with other retailers and expanding into the jobber market, thereby adding additional competition in the “do it for me” business segment targeting the professional technician.

As automotive parts grow more complex, consumers are less likely to service their own vehicles and may become more reliant on dealers and technicians. In addition to new car sales, automotive dealerships sell OE brand parts and service vehicles. The products available through the dealers are purchased through the original equipment service (OES) network. Traditionally, the parts manufacturers of OEMs have supplied a majority of OES network. However, certain parts manufacturers have become independent and are no longer affiliated with OEMs. As a result of this, there are additional opportunities for independent automotive aftermarket manufacturers like us to supply the OES network.

We believe that our sales force is the premier direct sales force for our product lines, due to our concentration of highly-qualified, well-trained sales people dedicated to geographic territories, which allows us to provide customer service we believe is unmatched by our competitors. From the outset, we thoroughly train our sales people both in the function and application of our product lines, as well as in proven sales techniques. Customers, therefore, depend on these sales people as a reliable source for

technical information. We give newly hired sales people extensive instruction at our training facility in Irving, Texas and have a policy of continuing education that allows our sales force to stay current on troubleshooting and repair techniques, as well as the latest automotive parts and systems technology.

We generate demand for our products by directing a significant portion of our sales effort to our customers' customers (i.e., jobbers and professional technicians). We also conduct instructional clinics, which teach technicians how to diagnose and repair complex systems related to our products. To help our sales people to be teachers and trainers, we focus our recruitment efforts on candidates who already have strong technical backgrounds as well as sales experience. We also create demand for our products through the Standard Plus Club. Our Standard Plus Club, a professional service dealer network, offers technical and business development support and has a technical service telephone hotline which provides immediate diagnostic and installation support. This club is available to technicians and provides training, special discount programs and on-line diagnostic assistance.

In connection with our sales activities, we offer a variety of customer discounts, allowances and incentives. For example, we offer cash discounts for paying invoices in accordance with the specified discounted terms of the invoice, and we offer pricing discounts based on volume and different product lines purchased from us. We also offer rebates and discounts to customers as advertising and sales force allowances, and allowances for warranty and overstock returns are also provided. We believe these discounts, allowances and incentives are a common practice throughout the automotive aftermarket industry, and we intend to continue to offer them in response to competitive pressures.

## **Customers**

Our customer base is comprised largely of warehouse distributors, large retailers, OES customers, other manufacturers and export customers. Our warehouse distributor customers include CARQUEST and NAPA Auto Parts, and our retail customers include Advance Auto Parts, AutoZone, CSK Auto, O'Reilly Automotive and Pep Boys. In 2006, our consolidated net sales to our major market channels consisted of \$411 million to our traditional customers, \$262 million to our retail customers, \$59 million to our OES customers and \$80 million to other customers.

Our five largest individual customers, including members of a marketing group, accounted for 51% of our 2006 consolidated net sales. Two individual customers accounted for 18% and 14%, respectively, of our 2006 consolidated net sales.

## **Competition**

We are a leading independent manufacturer of replacement parts for product lines in Engine Management and Temperature Control. We compete primarily on the basis of product quality, product availability, customer service, product coverage, order turn-around time, order fill rate and price. We believe we differentiate ourselves from our competitors primarily through:

- a value-added, knowledgeable sales force;
- extensive product coverage;
- sophisticated parts cataloging systems; and
- inventory levels sufficient to meet the rapid delivery requirements of customers.

In the Engine Management business, we are one of the leading independent manufacturers in the United States. Our competitors include AC Delco, Cardone Industries, Inc., Delphi Corporation, Denso Corporation, Federal-Mogul Corporation, Robert Bosch Corporation, Visteon Corporation and Wells Manufacturing Corporation, as well as OE dealers.

Our Temperature Control business is one of the leading independent producers and distributors of a full line of temperature control products in North America and other geographic areas. AC Delco, Delphi



Corporation, Denso Corporation, Jordan Automotive Aftermarket, Inc., Proliance International, Inc., Siemens VDO Automotive and Visteon Corporation are some of our key competitors in this market.

The automotive aftermarket is highly competitive, and we face substantial competition in all markets that we serve. Our success in the marketplace continues to depend on our ability to offer competitive prices, improved products and expanded offerings in competition with many other suppliers to the aftermarket. Some of our competitors may have greater financial, marketing and other resources than we do. In addition, we face competition from automobile manufacturers who supply virtually every replacement part sold by us, although these manufacturers generally supply parts only for cars they produce through OE dealerships.

### **Seasonality**

Historically, our operating results have fluctuated by quarter, with the greatest sales occurring in the second and third quarters of the year, with 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 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 borrowings 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 traditionally offer a pre-season selling program, known as our “Spring promotion,” in which customers are offered longer payment terms.

### **Working Capital Management**

Automotive aftermarket companies have been under increasing pressure to provide broad SKU (stock keeping unit) coverage in response to parts and brand proliferation. In response to this, we have made and continue to make changes to our inventory management system designed to reduce inventory requirements. We implemented a forecasting system in our Engine Management Segment that permitted a significant reduction in safety stocks. Our Engine Management Segment also introduced a new distribution system, which permits pack-to-order systems to be implemented. Such systems permit us to retain slow moving items in a bulk storage state until an order for a specific brand part is received. This system reduces the volume of a given part in inventory and reduces the labor requirements to package and repackage inventory. We also recently expanded our management system to improve inventory deployment, enhance our collaboration with customers on forecasts, and further integrate our supply chain both to customers and suppliers.

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. 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 returns, we tightened the rules to reduce returns arising from installer error or misdiagnosis. For example, with respect to our air conditioning compressors, our most significant customer product warranty returns, we established procedures whereby a warranty will be voided if a customer does not provide acceptable proof that complete AC system repair was performed. In addition, in order to better control overstock return levels, we placed further restrictions on the amounts customers can return and instituted a program so that our management can better estimate potential future product returns.

Our profitability and working capital requirements are seasonal due to our sales mix of 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. These increased working capital requirements are funded by borrowings from our revolving credit facility.

## **Suppliers**

The principal raw materials purchased by us consist of brass, electronic components, fabricated copper (primarily in the form of magnet and insulated cable), steel magnets, laminations, tubes and shafts, stamped steel parts, copper wire, ignition wire, stainless steel coils and rods, aluminum coils, fittings, tubes and rods, cast aluminum parts, lead, steel roller bearings, rubber molding compound, thermo-set and thermo plastic molding powders. Additionally, we use components and cores (used parts) in our remanufacturing processes for air conditioning compressors.

We purchase many materials in the U.S. and foreign open markets and have a limited number of supply agreements on key components. A number of prime suppliers make these materials available. In the case of cores for air conditioning compressors, we obtain them either from exchanges with customers who return cores subsequent to purchasing remanufactured parts or through direct purchases from a network of core brokers. In addition, we acquire certain materials by purchasing products that are resold into the market, particularly by OEM sources and other domestic and foreign suppliers.

We believe there is an adequate supply of primary raw materials and cores. In order to ensure a consistent, high quality, low cost supply of key components for each product line, we continue to develop our own sources through internal manufacturing capacity. Recently, prices of steel, aluminum, copper and other commodities have risen. These increases did not have a material impact on us, as we are not dependent on any single commodity, however, there can be no assurance over the long term that increases in commodity prices will not materially affect our business or results of operations.

## **Production and Engineering**

We engineer, tool and manufacture many of the components used in the assembly of our products. We also perform our own plastic and rubber molding operations, stamping and machining operations, automated electronics assembly and a wide variety of other processes. In the case of remanufactured components, we conduct our own teardown, diagnostics and rebuilding for air conditioning compressors. We have found this level of vertical integration to provide advantages in terms of cost, quality and availability. We intend to continue selective efforts toward further vertical integration to ensure a consistent quality and supply of low cost components. In addition, our strategy includes sourcing certain products from low cost countries such as those in Asia.

In 2000, we launched a program for the installation of a fully integrated enterprise resource planning (ERP) system. The implementation of such system was completed in 2003 at all of our Temperature Control Segment locations. In 2005, we launched our program to implement such a system in our Engine Management Segment, and we anticipate full implementation in 2009.

## **Employees**

As of December 31, 2006, we employed approximately 3,000 people in the United States, and 1,000 people in Mexico, Canada, Puerto Rico, Europe and Hong Kong. Of these, approximately 2,100 are production employees. We operate primarily in non-union facilities and have binding labor agreements with the workers at our two unionized facilities. We have approximately 160 production employees in Edwardsville, Kansas who are covered by a contract with The International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (“UAW”) that expires April 1, 2009. As of December 31, 2006, approximately 150 of our production employees in Long Island City, New York are under a UAW contract that expires October 1, 2007. We also have a union relationship in Mexico with an agreement negotiated each year. The current union agreement in Mexico, which covers approximately 300 employees, expires on January 28, 2008. We believe that our facilities are in favorable labor markets with ready access to adequate numbers of skilled and unskilled workers, and we believe our relations with our union and non-union employees are good.

## **Insurance**

We maintain basic liability coverage up to \$2 million for automobile liability, general and product liability and \$50 million for umbrella liability coverage. We also maintain two \$10 million environmental policies, each covering a separate number of our existing U.S. facilities. One of our facilities is currently undergoing minor environmental remediation. The environmental remediation costs at such facility are covered by an insurance policy of \$3 million, which is subject to a \$1.5 million deductible; we have purchased additional environmental insurance coverage in the amount of \$2 million with a \$0.1 million deductible relating to such facility. Historically, we have not experienced casualty losses in any year in excess of our coverage. We have no reason to expect this experience to change, but there can be no assurances that liability losses in the future will not exceed our coverage.

## **Available Information**

We are a New York corporation founded in 1919. Our principal executive offices are located at 37-18 Northern Boulevard, Long Island City, New York 11101, and our main telephone number at that location is (718) 392-0200. Our Internet address is [www.smpcorp.com](http://www.smpcorp.com). We provide a link to reports that we have filed with the SEC. However, for those persons that make a request in writing or by e-mail ([financial@smpcorp.com](mailto:financial@smpcorp.com)), we will provide free of charge our Annual Report on Form 10-K, our Quarterly Reports on Form 10-Q, our Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. These reports and other information are also available, free of charge, at [www.sec.gov](http://www.sec.gov). Alternatively, you may read and copy any materials that we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

## ITEM 1A. RISK FACTORS

**Our industry is highly competitive, and our success depends on our ability to compete with suppliers of automotive aftermarket products, some of which may have substantially greater financial, marketing and other resources than we do.**

While we believe that our business is well positioned to compete in our two primary market segments, Engine Management and Temperature Control, the automotive aftermarket industry is highly competitive, and our success depends on our ability to compete with suppliers of automotive aftermarket products. In the Engine Management business, our competitors include AC Delco, Cardone Industries, Inc., Delphi Corporation, Denso Corporation, Federal-Mogul Corporation, Robert Bosch Corporation, Visteon Corporation and Wells Manufacturing Corporation. In the Temperature Control business, we compete with AC Delco, Delphi Corporation, Denso Corporation, Jordan Automotive Aftermarket, Inc., Proliance International, Inc., Siemens VDO Automotive and Visteon Corporation. In addition, automobile manufacturers supply virtually every replacement part we sell.

Some of our competitors may have larger customer bases and significantly greater financial, technical and marketing resources than we do. These factors may allow our competitors to:

- respond more quickly than we can to new or emerging technologies and changes in customer requirements by devoting greater resources than we can to the development, promotion and sale of automotive aftermarket products and services;
- engage in more extensive research and development;
- sell products at a lower price than we do;
- undertake more extensive marketing campaigns; and
- make more attractive offers to existing and potential customers and strategic partners.

We cannot assure you that our competitors will not develop products or services that are equal or superior to our products or that achieve greater market acceptance than our products or that in the future other companies involved in the automotive aftermarket industry will not expand their operations into product lines produced and sold by us. We also cannot assure you that additional entrants will not enter the automotive aftermarket industry or that companies in the aftermarket industry will not consolidate. Any of such competitive pressures could cause us to lose market share or could result in significant price decreases and could have a material adverse effect upon our business, financial condition and results of operations.

**There is substantial price competition in our industry, and our success and profitability will depend on our ability to maintain a competitive cost and price structure.**

There is substantial price competition in our industry, and our success and profitability will depend on our ability to maintain a competitive cost and price structure. This is the result of a number of industry trends, including the impact of offshore suppliers in the marketplace, the consolidated purchasing power of large customers and actions taken by some of our competitors in an effort to “win over” new business. We have in the past had to, and may in the future have to, reduce prices to remain competitive. Price reductions have impacted our sales and profit margins and are expected to do so in the future. Also, our future profitability will depend in part upon our ability to respond to changes in the product and distribution channel mix, to continue to improve our manufacturing efficiencies, to generate cost reductions, including reductions in the cost of components purchased from outside suppliers, and to maintain a cost structure that will enable us to offer competitive prices. Our inability to maintain a competitive cost structure could have a material adverse effect on our business, financial condition and results of operations.

**We depend on a limited number of key customers, and the loss of any such customer could have a material adverse effect on our business, financial condition and results of operations.**

Our five largest individual customers, including members of a marketing group, accounted for 51%, 52% and 50% of our consolidated net sales for 2006, 2005 and 2004, respectively. Two individual customers accounted for 18% and 14%, respectively, of our 2006 consolidated net sales, 18% and 15%, respectively, of our 2005 consolidated net sales, and 17% and 14%, respectively, of our 2004 consolidated net sales. The loss of one or more of these customers or, if any of them ceases to acquire a significant product line, could have a materially adverse impact on our business, financial condition and results of operations.

Also, we do not typically enter into long-term agreements with any of our customers. Instead, we enter into a number of purchase order commitments with our customers, based on their current or projected needs. We have in the past and may in the future lose customers or lose a particular product line of a customer due to the highly competitive conditions in the automotive aftermarket industry, including pricing pressures. A decision by any significant customer, whether motivated by competitive conditions, financial difficulties or otherwise, to materially decrease the amount of products purchased from us, to change their manner of doing business with us, or to stop doing business with us, could have a material adverse effect on our business, financial condition and results of operations.

**Our business is seasonal and is subject to substantial quarterly fluctuations, which impact our quarterly performance and working capital requirements.**

Historically, our operating results have fluctuated by quarter, with the greatest sales occurring in the second and third quarters of the year and with 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 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.

**We may incur material losses and significant costs as a result of warranty-related returns by our customers in excess of anticipated amounts.**

Our products are required to meet rigorous standards imposed by our customers and our industry. 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 the event that there are material deficiencies or defects in the design and manufacture of our products and/or installer error, the affected products may be subject to warranty returns and/or product recalls. Although we maintain a comprehensive quality control program, we cannot give any assurance that our products will not suffer from defects or other deficiencies or that we will not experience material warranty returns or product recalls in the future.

We accrue for warranty returns as a percentage of sales, after giving consideration to recent historical returns. While we believe that we make reasonable estimates for warranty returns in accordance with our revenue recognition policies, actual returns may differ from our estimates. We have in the past incurred, and may in the future incur, material losses and significant costs as a result of our customers returning products to us as a result of warranty-related issues in excess of anticipated amounts. Deficiencies or defects in our products in the future may result in warranty returns and product recalls in excess of



anticipated amounts and may have a material adverse effect on our business, financial condition and results of operations.

**Our profitability may be materially adversely affected as a result of overstock inventory-related returns by our customers in excess of anticipated amounts.**

We permit overstock returns of inventory that we allow customers to return to us and that may be either new or non-defective or non-obsolete but that we believe we can re-sell. Customers are generally limited to returning overstocked inventory according to a specified percentage of their annual purchases from us. In addition, a customer's annual allowance cannot be carried forward to the upcoming year.

We accrue for overstock returns as a percentage of sales, after giving consideration to recent historical returns. While we believe that we make reasonable estimates for overstock returns in accordance with our revenue recognition policies, actual returns may differ from our estimates. To the extent that overstocked returns are materially in excess of our projections, our business, financial condition and results of operations may be materially adversely affected.

**Over the long term, our business is dependent on the automotive industry, and our future performance may be materially adversely affected by persistent declines in the automotive industry or changes in technologies and improvements in the quality of new vehicle parts.**

Over the long term, our business is dependent upon the sales of automobiles within the automotive industry, which creates the total number of vehicles available for repair following the expiration of vehicle warranties. A persistent decline in automotive sales and production over the long term would likely affect sales to our aftermarket customers. Changes in automotive technologies, such as vehicles powered by fuel cells or electricity, could also negatively affect sales to our aftermarket customers. These factors could result in less demand for our products thereby resulting in a decline in our results of operations or a deterioration in our business and financial condition and may have a material adverse effect on our long-term performance.

In addition, the size of the automobile replacement parts market depends, in part, upon the growth in number of vehicles on the road, increase in average vehicle age, increase in total miles driven per year, new and modified environmental regulations, increase in pricing of new cars and new car quality and related warranties. The automobile replacement parts market has been negatively impacted by the fact that the quality of more recent automotive vehicles and their component parts has improved, thereby lengthening the repair cycle. Generally, if parts last longer, there will be less demand for our products, and the average useful life of automobile parts has been steadily increasing in recent years due to innovations in products and technology. These factors could have a material adverse effect on our business, financial condition and results of operations.

**We may be materially adversely affected by asbestos claims arising from products sold by our former brake business, as well as by other product liability claims.**

In 1986, we acquired a brake business, which we subsequently sold in March 1998. 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 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 of such claims. We currently do not have insurance coverage for the defense and indemnity costs associated with the claims we face.

Actuarial consultants with experience in assessing asbestos-related liabilities conducted a study to estimate our potential claim liability 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. 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.

At December 31, 2006, approximately 3,270 cases were outstanding for which we were responsible for any related liabilities. Since inception in September 2001 through February 28, 2007, the amounts paid for settled claims are approximately \$5 million. A substantial increase in the number of new claims or increased settlement payments or awards of damages could have a material adverse effect on our business, financial condition and results of operations.

Given the uncertainties associated with projecting asbestos-related matters into the future and other factors outside our control, we cannot give any assurance that significant increases in the number of claims filed against us will not occur, that asbestos-related damages or settlement awards will not exceed the amount we have in reserve, or that additional provisions will not be required. Management will continue to monitor the circumstances surrounding these potential liabilities in determining whether additional reserves and provisions may be necessary. We plan on performing a similar annual actuarial analysis during the third quarter of each year for the foreseeable future.

In addition to asbestos-related claims, our product sales entail the risk of involvement in other product liability actions. We maintain product liability insurance coverage, but we cannot give any assurance that current or future policy limits will be sufficient to cover all possible liabilities. Further, we can give no assurance that adequate product liability insurance will continue to be available to us in the future or that such insurance may be maintained at a reasonable cost to us. In the event of a successful product liability claim against us, a lack or insufficiency of insurance coverage could have a material adverse effect on our business, financial condition and results of operations.

#### **Our substantial indebtedness could negatively affect our financial health.**

We have a significant amount of indebtedness. As of December 31, 2006, our total outstanding indebtedness was \$238.3 million. We incurred \$90 million of indebtedness in July 1999 from the sale of our convertible debentures. We have an existing revolving bank credit facility of \$305 million with General Electric Capital Corporation, as agent, and a syndicate of lenders, which we refer to throughout this Report as our revolving credit facility. As of December 31, 2006, we had \$133.3 million of outstanding indebtedness and approximately \$82.5 million of availability under this revolving credit facility. Our substantial indebtedness could:

- increase our vulnerability to general adverse economic and industry conditions;
- limit our ability to fund future working capital, capital expenditures, research and development costs and other general corporate requirements;
- limit our ability to pay future dividends;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- increase the amount of interest expense that we have to pay because some of our borrowings are at variable rates of interest, which, if interest rates increase, could result in a higher interest expense; and
- limit, along with the financial and other restrictive covenants of our indebtedness, among other things, our ability to borrow additional funds.

In addition, we have granted the lenders under our revolving credit facility a first priority security interest in substantially all of our currently owned and future acquired personal property, real property (other than our Long Island City facility) and other assets. We have also pledged shares of stock in our subsidiaries to those lenders. In addition, our revolving credit facility requires us to meet specified financial ratios and limits our ability to enter into various transactions. If we default on any of our indebtedness, or if we are unable to obtain necessary liquidity, our business could be adversely affected.

**We may not be able to generate the significant amount of cash needed to service our indebtedness and fund our future operations.**

Our ability either to make payments on or to refinance our indebtedness, or to fund planned capital expenditures and research and development efforts, will depend on our ability to generate cash in the future. Our ability to generate cash is in part subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Based on our current level of operations, we believe our cash flow from operations, available cash and available borrowings under our revolving credit facility will be adequate to meet our future liquidity needs for at least the next few years. Significant assumptions underlie this belief, including, among other things, that there will be no material adverse developments in our business, liquidity or capital requirements. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as:

- reducing capital expenditures;
- reducing research and development efforts;
- selling assets;
- restructuring or refinancing our indebtedness; and
- seeking additional funding.

We cannot assure you that our business will generate sufficient cash flow from operations, or that future borrowings will be available to us under our revolving credit facility in amounts sufficient to enable us to pay the principal and interest on our indebtedness or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness on or before maturity. We cannot assure you that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all.

**Our business is dependent on our maintaining satisfactory relationships with suppliers, and the loss of several major suppliers of raw materials or key components may have a material adverse effect on our operations.**

Our business depends on our relationships with suppliers of raw materials and components that we use on our product lines and on our ability to purchase these raw materials and key components at prices and on terms comparable to similarly-situated companies. We purchase most materials in the U.S. open market. Although we do not expect that the loss of any one supplier would have a material adverse effect on us, the loss of several major suppliers would have a material adverse effect on our business, financial condition and results of operations.

**We may incur liabilities under government regulations and policies and environmental laws, which may have a material adverse effect on our business, financial condition and results of operations.**

Domestic and foreign political developments and government regulations and policies directly affect automotive consumer products in the United States and abroad. Regulations and policies relating to over-the-highway vehicles include standards established by the United States Department of Transportation for motor vehicle safety and emissions. The modification of existing laws, regulations or policies, or the adoption of new laws, regulations or policies, could have a material adverse effect on our business,

financial condition and results of operations. Our failure to comply with these laws and regulations could subject us to civil and criminal penalties.

Our operations and properties are also subject to a wide variety of increasingly complex and stringent federal, state, local and international laws and regulations, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of materials, substances and wastes, the remediation of contaminated soil and groundwater and the health and safety of employees. Such environmental laws, including but not limited to those under the Comprehensive Environmental Response Compensation & Liability Act, may impose joint and several liability and may apply to conditions at properties presently or formerly owned or operated by an entity or its predecessors, as well as to conditions at properties at which wastes or other contamination attributable to an entity or its predecessors have been sent or otherwise come to be located.

The nature of our operations exposes us to the risk of claims with respect to such matters, and we can give no assurance that violations of such laws have not occurred or will not occur or that material costs or liabilities will not be incurred in connection with such claims. One of our facilities is currently undergoing minor environmental remediation. The environmental remediation costs at such facility are covered by an insurance policy of \$3 million, which is subject to a \$1.5 million deductible; we have purchased additional environmental insurance coverage in the amount of \$2 million with a \$0.1 million deductible relating to such facility. We also maintain two \$10 million environmental policies to cover our existing U.S. facilities. Based upon our experience to date, we believe that the future cost of compliance with existing environmental laws, and liability for known environmental claims pursuant to such environmental laws, will not give rise to additional significant expenditures or liabilities that would be material to us. However, future events, such as new information, changes in existing environmental laws or their interpretation, and more vigorous enforcement policies of federal, state or local regulatory agencies, may have a material adverse effect on our business, financial condition and results of operations.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

## ITEM 2. PROPERTIES

We maintain our executive offices and a manufacturing plant in Long Island City, New York. The table below describes our principal physical properties.

<u>Location</u>	<u>State or Country</u>	<u>Principal Business Activity</u>	<u>Approx. Square Feet</u>	<u>Owned or Expiration Date of Lease</u>
<i>Engine Management</i>				
Orlando	FL	Manufacturing (Ignition)	50,640	2017
Mishawaka	IN	Manufacturing	153,070	Owned
Edwardsville	KS	Manufacturing and Distribution (Wire)	355,000	Owned
Independence	KS	Manufacturing	273,390	Owned
Wilson	NC	Manufacturing (Ignition)	31,500	Owned
Reno	NV	Distribution (Ignition)	67,000	Owned
Long Island City	NY	Administration and Manufacturing (Ignition)	294,000	Owned
Greenville	SC	Manufacturing (Ignition)	181,525	Owned
Disputanta	VA	Distribution (Ignition)	411,000	Owned
Hong Kong	HK	Manufacturing (Ignition)	21,350	2008
Fajardo	Puerto Rico	Manufacturing (Ignition)	113,900	2007
Reynosa	Mexico	Manufacturing (Wire)	62,500	2009
Reynosa	Mexico	Manufacturing (Wire)	100,000	2014
Reynosa	Mexico	Manufacturing (Ignition)	110,000	2009
<i>Temperature Control</i>				
Corona	CA	Manufacturing and Distribution	78,200	2008
Lewisville	TX	Administration and Distribution	415,000	2009
Fort Worth	TX	Manufacturing and Distribution	204,000	Owned
Grapevine	TX	Manufacturing	180,000	Owned
St. Thomas	Canada	Manufacturing	40,000	Owned
Reynosa	Mexico	Remanufacturing (Compressors)	80,140	2009
<i>Europe</i>				
Nottingham	England	Administration and Distribution (Ignition and Wire)	29,000	Owned
Nottingham	England	Manufacturing (Ignition)	46,780	Owned
Wellingborough	England	Manufacturing (Wire)	18,500	2017
Bialystok	Poland	Manufacturing (Ignition)	42,050	2011
<i>Other</i>				
Mississauga	Canada	Administration and Distribution (Ignition, Wire, Temperature Control)	128,400	2016
Irving	TX	Training Center	13,400	2009

The real property that we own in Indiana, Kansas, Nevada, South Carolina, Virginia and Texas and in St. Thomas, Canada is encumbered by a mortgage or deed of trust, as applicable, in favor of General Electric Capital Corporation or its affiliated company, as agent for our revolving credit facility. In addition, the real property that we own in Long Island City, New York is encumbered by a mortgage in favor of Wells Fargo Bank N.A., and the real property we own in England is encumbered by a lien in favor of the Royal Bank of Scotland.

### **ITEM 3. 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 in the accompanying consolidated financial statements. 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, 2006, approximately 3,270 cases were outstanding for which we were responsible for any related liabilities. We expect the outstanding cases to increase gradually due to recent legislation in certain states mandating minimum medical criteria before a case can be heard. Since inception in September 2001 through February 28, 2007, the amounts paid for settled claims are approximately \$5 million. We do not have insurance coverage for the defense and indemnity costs associated with these claims. See note 20 of the notes to consolidated financial statements for further discussion.

On November 30, 2004, the Company was 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 filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments were originally scheduled for September 2006, however the court adjourned these proceedings until a later date to be determined. Subsequently, the judge initially assigned to the case excused himself, and a new judge has been assigned. 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

## PART II

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

Our common stock trades publicly on the New York Stock Exchange under the trading symbol "SMP." The following table shows the high and low sales prices per share of our common stock as reported by the New York Stock Exchange and the dividends declared per share for the periods indicated:

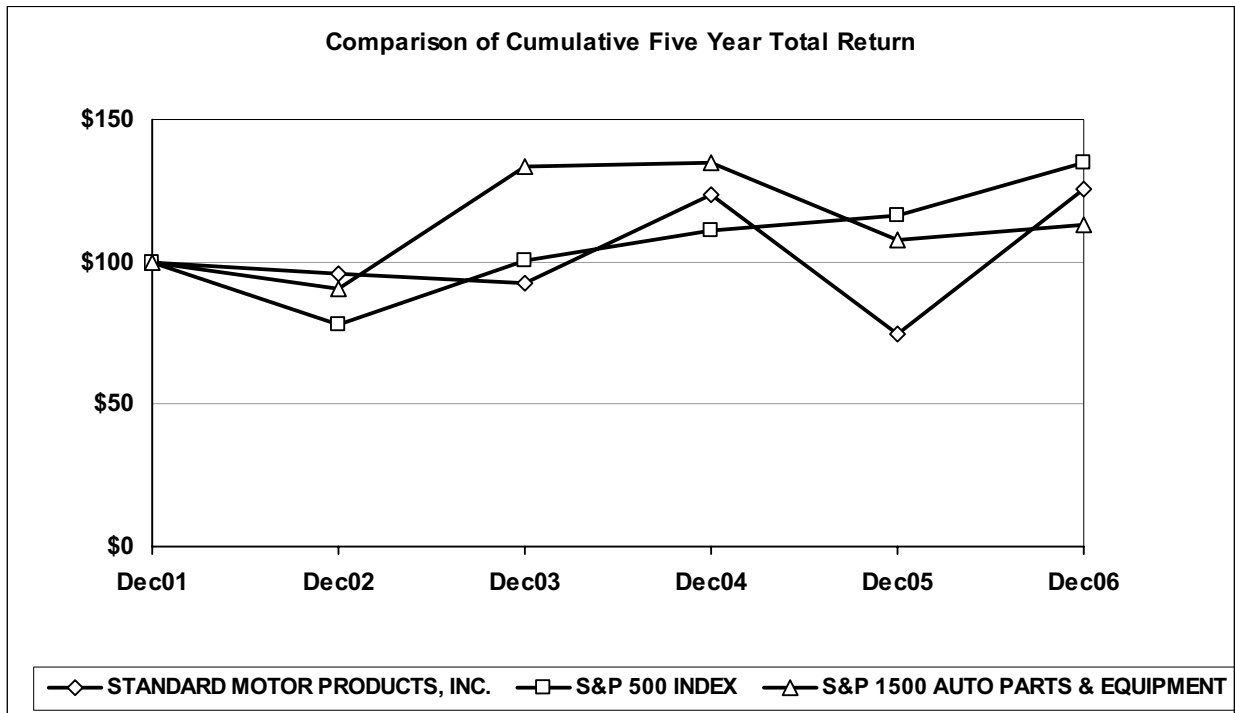
	<u>High</u>	<u>Low</u>	<u>Dividend</u>
<b>Fiscal Year ended December 31, 2006</b>			
First Quarter .....	\$11.10	\$8.55	\$0.09
Second Quarter.....	9.11	6.75	0.09
Third Quarter .....	12.64	7.10	0.09
Fourth Quarter.....	15.70	9.55	0.09
<b>Fiscal Year ended December 31, 2005</b>			
First Quarter .....	\$16.00	\$11.15	\$0.09
Second Quarter.....	13.60	8.81	0.09
Third Quarter .....	14.17	7.70	0.09
Fourth Quarter.....	9.55	7.88	0.09

The last reported sale price of our common stock on the NYSE on February 28, 2007 was \$15.38 per share. As of February 28, 2007, there were 561 holders of record of our common stock.

Dividends are declared and paid on the common stock at the discretion of our board of directors and depend on our profitability, financial condition, capital needs, future prospects, and other factors deemed relevant by our board. Our current policy is to pay dividends on a quarterly basis. Our revolving credit facility permits dividends and distributions by us provided specific conditions are met. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" for a further discussion of our revolving credit facility.

There have been no unregistered offerings of our common stock nor any repurchases of our common stock during the period covered by this Report.

The following graph compares the five year cumulative total return on the Company's Common Stock to the total returns on the Standard & Poor's 500 Stock Index and the S&P 1500 Auto Parts & Equipment Index, which is a combination of automotive parts and equipment companies within the S&P 400, the S&P 500 and the S&P 600. The graph shows the growth of a \$100 investment in the Company's Common Stock and each of the above indices on December 31, 2001 and the reinvestment of all dividends. The comparisons in this table are required by the Securities and Exchange Commission and are not intended to forecast or be indicative of possible future performance of the Company's Common Stock or the referenced indices.



	SMP	S&P 500	S&P 1500 Auto Parts & Equipment Index
2001.....	\$100	\$100	\$100
2002.....	96	78	91
2003.....	93	100	134
2004.....	123	111	135
2005.....	75	117	108
2006.....	125	135	113

\* Source: Standard & Poor's



## ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial data for the five years ended December 31, 2006. This selected consolidated financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our financial statements and the notes thereto included elsewhere in this Form 10-K.

	Year Ended December 31,				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(Dollars in thousands)				
<b>Statement of Operations Data:</b>					
Net sales (1).....	\$ 812,024	\$830,413	\$824,283	\$678,783	\$598,437
Gross profit (1).....	205,221	185,980	194,993	174,772	157,544
Goodwill impairment charge (3) .....	—	—	6,429	—	3,334
Operating income (loss).....	35,315	14,082	(1,737)	15,815	25,068
Earnings (loss) from continuing operations (2) .....	9,163	(1,770)	(8,907)	224	6,091
Earnings (loss) from discontinued operation, net of tax.....	248	(1,775)	(3,909)	(1,742)	(18,297)
Cumulative effect of accounting change, net of tax (3)(4) .....	—	—	(1,564)	—	(18,350)
Net earnings (loss) (5).....	9,411	(3,545)	(14,380)	(1,518)	(30,556)
<b>Per Share Data:</b>					
Earnings (loss) from continuing operations:					
Basic.....	\$ 0.50	\$ (0.09)	\$ (0.46)	\$ 0.01	\$ 0.51
Diluted.....	0.50	(0.09)	(0.46)	0.01	0.51
Earnings (loss) per common share:					
Basic.....	0.51	(0.18)	(0.74)	(0.10)	(2.57)
Diluted.....	0.51	(0.18)	(0.74)	(0.10)	(2.54)
Cash dividends per common share.....	0.36	0.36	0.36	0.36	0.36
<b>Other Data:</b>					
Depreciation and amortization .....	\$ 15,486	\$ 17,356	\$ 19,013	\$ 17,092	\$ 16,128
Capital expenditures.....	10,080	9,957	9,774	8,926	7,598
Dividends.....	6,579	7,024	6,955	5,615	4,290
<b>Balance Sheet Data (at period end):</b>					
Cash and cash equivalents.....	\$ 22,348	\$ 14,046	\$ 14,934	\$ 19,647	\$ 9,690
Working capital .....	183,313	169,768	194,760	191,333	140,683
Total assets.....	640,092	653,044	656,569	694,525	490,758
Total debt.....	238,320	248,327	224,186	217,810	176,917
Long-term debt (excluding current portion).....	97,979	98,549	114,236	114,757	93,191
Stockholders’ equity .....	190,699	185,707	207,312	226,041	153,881

- (1) We adopted the guidelines of the Emerging Issues Task Force (EITF) entitled “Accounting for Certain Sales Incentives” and “Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor’s Products,” on January 1, 2003. These guidelines address when sales incentives and discounts should be recognized and the accounting for certain costs incurred by a vendor on behalf of a customer, as well as where the related revenues and expenses should be classified in the financial statements.

- (2) We adopted SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections," on January 1, 2003. The new guidance eliminates the automatic classification of gain or loss on extinguishment of debt as an extraordinary item of income and requires that such gain or loss be evaluated for extraordinary classification under the criteria of Accounting Principles Board ("APB") No. 30, Reporting Results of Operations.
- (3) We adopted SFAS No. 142, "Goodwill and Other Intangible Assets," ("SFAS No. 142") on January 1, 2002. The new guidance replaced the amortization of goodwill with periodic assessments of the fair value of goodwill. Our initial impairment test, performed as of January 1, 2002, indicated that the carrying amounts of some of our reporting units exceeded the corresponding fair values, which were determined based on the discounted estimated future cash flows of the reporting units, the Company's weighted average cost of capital and market multiples. As a result, we recorded an impairment loss on goodwill as a cumulative effect of accounting change of \$18.3 million during the first quarter of 2002. The impairment loss related to our European Segment and Temperature Control Segment for which we recorded a charge of \$10.9 million and \$7.4 million, respectively. We completed our annual impairment test of goodwill as of December 31, 2002 and after consideration to 2002 losses and budgeted 2003 losses, we recorded an impairment loss of \$3.3 million associated with the Engine Management reporting unit of our European Segment. Our annual impairment test of goodwill as of December 31, 2004, indicated that the carrying amounts of two of our reporting units exceeded the corresponding fair values. As a result, we recorded an impairment loss on goodwill of \$6.4 million during the fourth quarter of 2004. The impairment loss related to our European Segment and Temperature Control Segment for which we recorded a charge of \$1.6 million and \$4.8 million, respectively.
- (4) New customer acquisition costs refer to arrangements pursuant to which we incur change-over-costs to induce a new or existing 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 were initially recorded as a prepaid asset and the related expense was recognized ratably over a 12-month period beginning in the month following the stocklift as an offset to sales. In the fourth quarter of 2004, we determined that it was a preferable accounting method to reflect the customer acquisition costs as a reduction to revenue when incurred. We recorded a cumulative effect of a change in accounting for new customer acquisition costs totaling \$1.6 million, net of tax effects, and recorded the accounting change as if it had taken effect on October 1, 2004.
- (5) We recorded an after tax gain (loss) of \$0.2 million, \$(1.8) million and \$(3.9) million as a loss from discontinued operation to account for legal expenses and potential costs associated with our asbestos-related liability for the years ended December 31, 2006, 2005 and 2004, respectively. Such costs were also separately disclosed in the Operating Activity section of the Consolidated Statements of Cash Flows for those same years.

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

The following discussion should be read in conjunction with our consolidated financial statements and the notes thereto. This discussion summarizes the significant factors affecting our results of operations and the financial condition of our business during each of the fiscal years in the three year period ended December 31, 2006.

### 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, in June 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, our total purchase price was approximately \$130.5 million. In December 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 the DEM acquisition, we 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 \$12.8 million as of December 31, 2006. As of December 31, 2006, the remaining restructuring accrual was \$1.1 million. We expect to pay most of the remaining amount in 2007 and 2008.

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 years ended December 31, 2006 and 2005, termination benefits of \$0.2 million and \$2.3 million, respectively, have been charged to the restructuring accrual. As of December 31, 2006, the reserve balance for workforce reductions was \$0.5 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 December 31, 2006, leaving the exit reserve balance for exit costs at \$0.6 million as of December 31, 2006.

For additional information about our business, strategy and competitive environment, see Item 1, "Business."

**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 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 traditionally offer a pre-season selling program, known as our "Spring Promotion," in which customers are offered 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, with respect to our air conditioning compressors, our most significant customer product warranty returns, we established procedures whereby a warranty will be voided if a customer does not provide acceptable proof that complete AC system repair was performed.

**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.

### **Comparison of Fiscal Years 2006 and 2005**

**Sales.** Consolidated net sales for 2006 were \$812 million, a decrease of \$18.4 million or 2%, compared to \$830.4 million in 2005. The net sales decrease was primarily due to our Temperature Control net sales decreasing by \$18.1 million or 8% due to reduced demand resulting from a cooler summer than the prior year and competition from low cost foreign imports. Engine Management net sales also decreased by \$3.8 million or 0.7% mainly due to higher than average customer returns. Partially offsetting the decrease, net sales in Europe increased \$3.6 million.

**Gross margins.** Gross margins, as a percentage of consolidated net sales, increased by 2.9 percentage points to 25.3% in 2006 from 22.4% in 2005 mainly driven by Engine Management margin improvements of 4.5 percentage points. The margin increase in our Engine Management Segment reflected a combination of price increases and improved procurement and manufacturing costs. Temperature Control and Europe margin percentages remained stable due to improved production and procurement costs offsetting the effect of inflation.

**Selling, general and administrative expenses.** Selling, general and administrative (SG&A) expenses increased \$1.5 million to \$168.1 million or 20.7% of consolidated net sales in 2006, compared to \$166.6 million or 20.1% of consolidated net sales in 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 \$3.4 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 an increase in promotion spending and temporary overlapping costs as we transitioned from an outsourced to an internal returns processing center. 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 \$1.9 million for 2006, compared to \$5.3 million in 2005. The 2006 expenses related mostly to severance costs related to the move of our European and Puerto Rican production operations and the divestiture of a production unit of our Temperature Control Segment. Expenses in 2005 were primarily for a non-cash asset impairment charge of \$3.3 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 restructuring, which has since been substantially completed.

**Operating income.** Operating income increased by \$21.2 million to \$35.3 million in 2006, compared to \$14.1 million in 2005. The increase was primarily due to higher gross profit from Engine Management's 4.5 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 decreased \$3 million in 2006 compared to 2005, due to a \$3.2 million loss incurred on the sale of a majority portion of our European Temperature Control business, partially offset by higher foreign exchange gains. A benefit in 2005 was from a discount of \$1.3 million on a debt reduction not repeated in 2006.

**Interest expense.** Interest expense increased by \$2.2 million for 2006 compared to 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 at that time.

***Income tax provision.*** The income tax provision was \$6.5 million for 2006 compared to \$1.4 million for 2005. The increase was primarily due to higher pre-tax earnings and a higher effective rate for 2006 which was 41.5%. We had an increase in our on-going tax rate primarily due to the January 1, 2006, 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. This increase was offset in 2006 by the one-time impact of our Puerto Rico deferred tax assets becoming recoverable at the higher US tax rate. Our taxes were also higher as a result of recording a valuation allowance for the capital loss on disposition of our European Temperature Control business which is not expected to be recoverable in the future. Deferred tax assets of \$54.1 million, net of a valuation allowance of \$28 million and net of deferred tax liabilities of \$15.7 million, were \$38.4 million as of December 31, 2006. We have concluded that our current level of valuation allowance of \$28 million continues to be appropriate, as discussed in note 16 of the notes to our consolidated financial statements. The tax expense of \$1.4 million in 2005 on losses of \$0.3 million was mostly due to the recording of discrete items, namely with regards to a reduced statutory rate applicable to opening deferred tax assets and a larger increase to the tax valuation allowance.

***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 \$0.2 million as income and \$1.8 million as a loss, both net of tax, from discontinued operation for 2006 and 2005, respectively. The income for 2006 includes 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 2005 reflects only legal expenses. As discussed more fully in note 20 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 2006, cash provided by operations amounted to \$33.7 million, compared to cash used in operations of \$2.2 million in 2005. The year over year improvement of \$35.9 million is primarily attributable to a lower increase in accounts receivable of \$13.8 million and increased net earnings. The greater increase in accounts receivable in 2005 was due to the end of the accounts receivable draft program in 2005 compared to 2004 when our major accounts were under the draft program. The lower increase in accounts receivable in 2006 reflects a stabilized situation with no draft program in place. Partially offsetting these improvements was a slight increase in inventory compared to a decrease of \$10 million in 2005, driven by our need to provide a bridge of inventory as we undergo a rationalization of our production facilities.

***Investing Activities.*** Cash used in investing activities was \$6 million in 2006, compared to \$7.8 million in the same period of 2005. The decrease of \$1.8 million was primarily due to proceeds from the sale of a majority portion of our European Temperature Control business in 2006.

***Financing Activities.*** Cash used in financing activities was \$20.2 million in 2006, compared to cash provided by financing activities of \$9.7 million in 2005. The change is primarily due to repayments made on our line of credit in 2006 due to an improvement in cash provided by operating activities and a decrease in our bank overdraft balances. The 2005 increase to our line of credit was driven by the settlement of the note held by Dana and the repurchase of the common stock held by Dana, which note and common stock were originally issued to Dana in connection with the DEM acquisition.

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 \$82.5 million available for us to borrow pursuant to the formula at December 31, 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, 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.

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. In December 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 5.5% 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 after 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 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 December 31, 2006, we have Board authorization to repurchase additional shares at a maximum cost of \$1.7 million. During 2006, we did not repurchase any shares of our common stock.

The following is a summary of our contractual commitments as of December 31, 2006:

<i>(in thousands)</i>	2007	2008	2009	2010	2011	2012-2016	Total
Principal payments of long term debt .....	\$ 542	\$ 570	\$90,586	\$ 620	\$ 655	\$ 5,548	\$ 98,521
Operating leases .....	6,657	5,614	4,446	2,059	1,913	8,582	29,271
Post retirement benefits .....	1,095	1,549	1,669	1,800	1,912	12,203	20,228
Severance payments related to integration .....	89	383	—	—	—	—	472
Total commitments .....	<u>\$8,383</u>	<u>\$8,116</u>	<u>\$96,701</u>	<u>\$4,479</u>	<u>\$4,480</u>	<u>\$26,333</u>	<u>\$148,492</u>

### 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. You should be aware that preparation of our consolidated annual and quarterly financial statements 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 actually 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 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.

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 December 31, 2006, the allowance for sales returns was \$21.7 million. Similarly, management must make estimates of the uncollectability of our accounts receivables. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer 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 December 31, 2006, the allowance for doubtful accounts and for discounts was \$9.5 million.

***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 December 31, 2006, we had a valuation allowance of \$28 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.

***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 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. 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 FASB Staff Position ("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.

## Recently Issued Accounting Pronouncements

### *Share-Based Payment*

Effective January 1, 2006, the Company adopted the provisions and accounts for stock-based compensation in accordance with 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. We have adopted SFAS 123R using a modified prospective application, under which prior periods are not revised for comparative purposes. 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 year ended December 31, 2006 was \$848,000 (\$516,100 net of tax) or \$0.03 per basic and diluted share. 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. The Company is 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 fiscal years beginning after November 15, 2007, which for the Company is the year ending December 31, 2008. The Company is 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 funded status of their defined benefit pension or postretirement plans on the consolidated balance sheet 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 adopted the recognition and related disclosure provisions of SFAS No. 158, prospectively, on December 31, 2006. The adoption of SFAS 158 resulted in an increase to total assets of \$1.2 million, an increase to total liabilities of \$2.6 million, and a decrease to shareholders' equity of \$1.4 million. 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. The Company is presently evaluating the impact of the measurement date change, which is not expected to be material.

The incremental effect of applying SFAS No. 158 on individual line items in the consolidated balance sheet at December 31, 2006 was as follows (in thousands):

	<b>Before Application of SFAS No. 158</b>	<b>Adjustments</b>	<b>After Application of SFAS No. 158</b>
Prepaid expenses and other current assets (current) .....	\$ 7,861	\$ (16)	\$ 7,845
Other assets (pension, deferred income taxes - non-current).....	40,658	<u>1,216</u>	41,874
Total assets.....	638,892	<u>1,200</u>	640,092
Sundry payables and accrued expenses (pension, current).....	25,610	(1,100)	24,510
Pension and post-retirement medical benefits (non-current).....	47,964	<u>3,714</u>	51,678
Total liabilities .....	446,779	<u>2,614</u>	449,393
Accumulated other comprehensive income (loss) .....	4,955	<u>(1,414)</u>	3,541
Total liabilities and stockholders' equity .....	\$638,892	<u>\$1,200</u>	\$640,092

#### *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. There was no impact of adopting SAB 108 to our consolidated financial position, results of operations and cash flows.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **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.

#### **Exchange Rate Risk**

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, 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 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.

#### **Interest Rate Risk**

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 have in the past entered into interest rate swap agreements.

In October 2003, we entered into an interest rate swap agreement with a notional amount of \$25 million that matured in October 2006. If, at any time, the swap was determined to be ineffective, in whole or in part, due to changes in the interest rate swap agreement, the fair value of the portion of the interest rate swap determined to be ineffective would have been recognized as gain or loss in the statement of operations for the applicable period. The hedge was effective throughout the time of the swap.

At December 31, 2006, we had approximately \$238.3 million in loans and financing outstanding, of which approximately \$98.5 million bear interest at fixed interest rates and approximately \$139.8 million bear interest at variable rates of interest. We invest our excess cash in highly liquid short-term investments. Our percentage of variable rate debt to total debt was 58.7% and 60% at December 31, 2006 and 2005, respectively. Depending upon the level of borrowings under our revolving credit facility and our excess cash, the effect of a hypothetical, instantaneous and unfavorable change of 100 basis points in the interest rate may have approximately \$1.6 million negative impact on our earnings or cash flows.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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**MANAGEMENT'S REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING**

To the Stockholders  
Standard Motor Products, Inc.:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) of the Exchange Act). Our internal control system was designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Because of these inherent limitations, internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and presentation, and may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on our assessment using those criteria, we concluded that, as of December 31, 2006, our internal control over financial reporting is effective.

Our independent registered public accounting firm, Grant Thornton LLP, has audited our consolidated financial statements for 2006 and has issued an attestation report concurring with management's assessment of our internal control over financial reporting. Grant Thornton's report appears on the following pages of this "Item 8. Financial Statements and Supplementary Data."

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM—  
INTERNAL CONTROL OVER REPORTING**

The Board of Directors and Shareholders  
Standard Motor Products, Inc.:

We have audited management's assessment, included in the accompanying Management's Report On Internal Control Over Financial Reporting, that Standard Motor Products, Inc. (a New York corporation) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Standard Motor Products, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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

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

In our opinion, management's assessment that Standard Motor Products, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by COSO. Also in our opinion, Standard Motor Products, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Standard Motor Products, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholder's equity and cash flows for each of the three years in the period ended December 31, 2006, and our report dated March 15, 2007 expressed an unqualified opinion on those consolidated financial statements and includes explanatory paragraphs relating to the application of Statement of Financial Accounting Standards No. 123(R) as of January 1, 2006 and No. 158 as of December 31, 2006.

New York, New York  
March 15, 2007



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM—  
CONSOLIDATED FINANCIAL STATEMENTS**

The Board of Directors and Stockholders  
Standard Motor Products, Inc.:

We have audited the accompanying consolidated balance sheets of Standard Motor Products, Inc. and Subsidiaries (a New York corporation) as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Standard Motor Products, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the consolidated financial statements, the Company changed its method of accounting for share-based compensation effective January 1, 2006, in connection with the adoption of Statement of Financial Statement Standards No. 123 (revised 2004) "Share-Based Payment."

As discussed in Notes 13 and 14 to the consolidated financial statements, the Company changed its method of accounting for defined benefit pension and other postretirement plans, effective as of December 31, 2006, in connection with the adoption of Statement of Financial Statement Standards No. 158, "Employers' Accounting for Defined Pension and Other Post Retirement Plans."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Standard Motor Products, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 15, 2007 expressed an unqualified opinion thereon.

New York, New York  
March 15, 2007

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2006	2005	2004
	(Dollars in thousands, except share and per share data)		
Net sales.....	\$ 812,024	\$ 830,413	\$ 824,283
Cost of sales.....	606,803	644,433	629,290
Gross profit.....	205,221	185,980	194,993
Selling, general and administrative expenses .....	168,050	166,556	178,852
Restructuring expenses .....	1,856	5,342	11,449
Goodwill impairment charge .....	—	—	6,429
Operating income (loss) .....	35,315	14,082	(1,737)
Other (expense) income, net .....	(383)	2,648	2,861
Interest expense .....	19,275	17,077	13,710
Earnings (loss) from continuing operations before taxes .....	15,657	(347)	(12,586)
Provision (benefit) for income taxes.....	6,494	1,423	(3,679)
Earnings (loss) from continuing operations.....	9,163	(1,770)	(8,907)
Earnings (loss) from discontinued operation, net of income tax of \$809, \$ 1,118 and \$2,606 .....	248	(1,775)	(3,909)
Earnings (loss) before cumulative effect of accounting change .....	9,411	(3,545)	(12,816)
Cumulative effect of accounting change, net of tax of \$1,043 .....	—	—	(1,564)
Net earnings (loss).....	\$ 9,411	\$ (3,545)	\$ (14,380)
Net earnings (loss) per common share – Basic:			
Earnings (loss) from continuing operations .....	\$ 0.50	\$ (0.09)	\$ (0.46)
Discontinued operation .....	0.01	(0.09)	(0.20)
Cumulative effect of accounting change .....	—	—	(0.08)
Net earnings (loss) per common share – Basic.....	\$ 0.51	\$ (0.18)	\$ (0.74)
Net earnings (loss) per common share – Diluted:			
Earnings (loss) from continuing operations .....	\$ 0.50	\$ (0.09)	\$ (0.46)
Discontinued operation .....	0.01	(0.09)	(0.20)
Cumulative effect of accounting change .....	—	—	(0.08)
Net earnings (loss) per common share – Diluted.....	\$ 0.51	\$ (0.18)	\$ (0.74)
Average number of common shares .....	18,283,707	19,507,818	19,331,358
Average number of common shares and dilutive common shares.....	18,325,175	19,507,818	19,331,358

See accompanying notes to consolidated financial statements.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
	<b>(Dollars in thousands, except share data)</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents.....	\$ 22,348	\$ 14,046
Accounts receivable, less allowances for discounts and doubtful accounts of \$9,465 and \$9,574 in 2006 and 2005, respectively .....	183,664	176,294
Inventories.....	233,970	243,297
Deferred income taxes.....	14,011	14,081
Prepaid expenses and other current assets.....	7,845	7,972
<b>Total current assets.....</b>	<b><u>461,838</u></b>	<b><u>455,690</u></b>
Property, plant and equipment, net .....	80,091	85,805
Goodwill and other intangibles, net.....	56,289	67,402
Other assets.....	41,874	44,147
<b>Total assets.....</b>	<b><u>\$ 640,092</u></b>	<b><u>\$ 653,044</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable .....	\$ 139,799	\$ 149,236
Current portion of long-term debt .....	542	542
Accounts payable .....	53,783	52,535
Sundry payables and accrued expenses.....	24,510	24,466
Accrued customer returns.....	21,705	22,346
Restructuring accrual.....	703	1,286
Accrued rebates .....	20,769	24,017
Payroll and commissions.....	16,714	11,494
<b>Total current liabilities.....</b>	<b><u>278,525</u></b>	<b><u>285,922</u></b>
Long-term debt .....	97,979	98,549
Post-retirement medical benefits and other accrued liabilities .....	51,678	45,962
Restructuring accrual .....	383	11,348
Accrued asbestos liabilities.....	20,828	25,556
<b>Total liabilities.....</b>	<b><u>449,393</u></b>	<b><u>467,337</u></b>
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	40,972
Capital in excess of par value.....	57,429	56,966
Retained earnings .....	112,481	109,649
Accumulated other comprehensive income .....	3,541	4,158
Treasury stock - at cost (2,109,816 and 2,315,645 shares in 2006 and 2005, respectively).....	(23,724)	(26,038)
<b>Total stockholders' equity .....</b>	<b><u>190,699</u></b>	<b><u>185,707</u></b>
<b>Total liabilities and stockholders' equity.....</b>	<b><u>\$ 640,092</u></b>	<b><u>\$ 653,044</u></b>

See accompanying notes to consolidated financial statements.

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<u>Year Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
	(In thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net earnings (loss) .....	\$ 9,411	\$ (3,545)	\$ (14,380)
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Depreciation and amortization .....	15,486	17,356	19,013
Increase to allowance for doubtful accounts .....	405	655	404
Increase to inventory reserves .....	6,128	5,286	1,487
Loss on disposal of property, plant and equipment .....	71	2,940	1,379
Loss on divestiture of European Temperature Control division .....	3,209	—	—
Gain on retirement of debt .....	—	(1,258)	—
Equity income from joint ventures .....	(915)	(955)	(752)
Employee stock ownership plan allocation .....	1,190	1,341	1,643
Stock-based compensation .....	848	—	—
Decrease (increase) in deferred income taxes .....	328	(4,760)	(6,243)
Increase (decrease) in tax valuation allowance .....	1,875	3,074	(182)
(Earnings) loss on discontinued operations, net of tax .....	(248)	1,775	3,909
Cumulative effect of accounting change .....	—	—	1,564
Goodwill impairment charge .....	—	—	6,429
Change in assets and liabilities, net of effects from acquisitions and divestitures:			
(Increase) decrease in accounts receivable .....	(11,758)	(25,597)	21,833
(Increase) decrease in inventories .....	(701)	10,058	(5,350)
(Increase) in prepaid expenses and other current assets .....	(43)	(491)	(82)
Decrease in other assets .....	313	1,237	3,662
Increase (decrease) in accounts payable .....	7,693	2,760	(12,376)
Decrease in sundry payables and accrued expenses .....	(2,637)	(6,968)	(5,969)
Decrease in restructuring accrual .....	(1,095)	(5,516)	(12,222)
Increase (decrease) in other liabilities .....	4,129	370	(301)
Net cash provided by (used in) operating activities .....	<u>33,689</u>	<u>(2,238)</u>	<u>3,466</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from the sale of property, plant and equipment .....	995	2,164	1,734
Capital expenditures, net of effects from acquisitions .....	(10,080)	(9,957)	(9,774)
Payments for acquisitions, net of cash acquired .....	—	—	(2,906)
Proceeds from the divestiture of European Temperature Control division .....	3,119	—	—
Net cash used in investing activities .....	<u>(5,966)</u>	<u>(7,793)</u>	<u>(10,946)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net borrowings under line-of-credit agreements .....	(9,082)	39,820	9,717
Principal payments and retirement of long-term debt .....	(570)	(14,655)	(3,341)
(Decrease) increase in overdraft balances .....	(4,716)	3,288	834
Repurchase of shares held by Dana Corporation .....	—	(11,899)	—
Proceeds from exercise of employee stock options .....	738	169	972
Dividends paid .....	(6,579)	(7,024)	(6,955)
Net cash (used in) provided by financing activities .....	<u>(20,209)</u>	<u>9,699</u>	<u>1,227</u>
Effect of exchange rate changes on cash .....	788	(556)	1,540
Net increase (decrease) in cash and cash equivalents .....	8,302	(888)	(4,713)
CASH AND CASH EQUIVALENTS at beginning of year .....	14,046	14,934	19,647
CASH AND CASH EQUIVALENTS at end of year .....	<u>\$ 22,348</u>	<u>\$ 14,046</u>	<u>\$ 14,934</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest .....	<u>\$ 19,224</u>	<u>\$ 17,227</u>	<u>\$ 13,741</u>
Income taxes .....	<u>\$ 2,976</u>	<u>\$ 3,456</u>	<u>\$ 2,582</u>
Non-cash investing and financing activities:			
Reduction of restructuring accrual applied against goodwill .....	<u>\$ 10,606</u>	<u>\$ 1,243</u>	<u>\$ 1,000</u>

See accompanying notes to consolidated financial statements.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Year Ended December 31, 2006, 2005 and 2004

(In thousands)	<u>Common Stock</u>	<u>Capital in Excess of Par Value</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Treasury Stock</u>	<u>Total</u>
BALANCE AT DECEMBER 31, 2003 .....	\$ 40,972	\$ 58,086	\$ 141,553	\$ 4,814	\$(19,384)	\$ 226,041
Comprehensive Loss:						
Net loss .....			(14,380)			(14,380)
Foreign currency translation adjustment..				2,242		2,242
Unrealized gain on interest rate swap agreements, net of tax of \$127 .....				383		383
Minimum pension liability adjustment ....				(2,634)		(2,634)
Total comprehensive loss .....						(14,389)
Cash dividends paid.....			(6,955)			(6,955)
Exercise of employee stock options .....		(645)			1,617	972
Employee Stock Ownership Plan .....		(17)			1,660	1,643
BALANCE AT DECEMBER 31, 2004 .....	40,972	57,424	120,218	4,805	(16,107)	207,312
Comprehensive Loss:						
Net loss .....			(3,545)			(3,545)
Foreign currency translation adjustment..				(940)		(940)
Unrealized gain on interest rate swap agreements, net of tax of \$108.....				26		26
Minimum pension liability adjustment ....				267		267
Total comprehensive loss .....						(4,192)
Cash dividends paid.....			(7,024)			(7,024)
Exercise of employee stock options .....		(71)			240	169
Employee Stock Ownership Plan .....		(387)			1,728	1,341
Repurchase of shares held by Dana Corporation.....					(11,899)	(11,899)
BALANCE AT DECEMBER 31, 2005 .....	40,972	56,966	109,649	4,158	(26,038)	185,707
Comprehensive Income:						
Net income .....			9,411			9,411
Foreign currency translation adjustment..				1,300		1,300
Unrealized gain on interest rate swap agreements, net of tax of \$(198) .....				(298)		(298)
Adoption of FASB Statement No. 158, net of income taxes of \$1,906.....				(1,414)		(1,414)
Additional minimum pension liability adjustment .....				(205)		(205)
Total comprehensive income .....						8,794
Cash dividends paid.....			(6,579)			(6,579)
Exercise of employee stock options .....		(49)			787	738
Stock based compensation.....		653			195	848
Employee Stock Ownership Plan .....		(141)			1,332	1,191
BALANCE AT DECEMBER 31, 2006 .....	\$ 40,972	\$ 57,429	\$ 112,481	\$ 3,541	\$ (23,724)	\$ 190,699

See accompanying notes to consolidated financial statements

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Summary of Significant Accounting Policies

##### *Principles of Consolidation*

Standard Motor Products, Inc. (referred to hereinafter in these notes to consolidated financial statements as “we,” “us” or “our”) is engaged in the manufacture and distribution of replacement parts for motor vehicles in the automotive aftermarket industry. The consolidated financial statements include our accounts and all subsidiaries in which we have more than a 50% equity ownership. Our investments in unconsolidated affiliates are accounted for on the equity method. All significant intercompany items have been eliminated.

##### *Use of Estimates*

In conformity with generally accepted accounting principles, we have made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements. Some of the more significant estimates include allowances for doubtful accounts, realizability of inventory, goodwill and other intangible assets, depreciation and amortization of long-lived assets, product liability, pensions and other post-retirement benefits, asbestos and litigation matters, deferred tax asset valuation allowance and sales return allowances. Actual results could differ from those estimates.

##### *Cash and Cash Equivalents*

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

##### *Allowance for Doubtful Accounts and Cash Discounts*

The Company does not generally require collateral for its trade accounts receivable. Accounts receivable have been reduced by an allowance for amounts that may become uncollectible in the future. These allowances are established based on a combination of write-off history, aging analysis, and specific account evaluations. When a receivable balance is known to be uncollectible, it is written off against the allowance for doubtful accounts. Cash discounts are provided based on an overall average experience rate applied to qualifying accounts receivable balances.

##### *Inventories*

Inventories are stated at the lower of cost (determined by means of the first-in, first-out method) or market. Inventories are reduced by an allowance for excess and obsolete inventories, based on the Company’s review of on-hand inventories. We provided for an inventory reserve of \$35.4 million and \$39.1 million as of December 31, 2006 and 2005, respectively.

We use 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 either in outright purchases from used parts brokers, 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 when it is actually received from the customer.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

***Derivative Instruments and Hedging Activities***

The Company recognizes derivatives as either an asset or liability measured at its fair value. For derivatives that have been formally designated as a cash flow hedge (interest rate swap agreements), the effective portion of changes in the fair value of the derivatives are recorded in “accumulated other comprehensive income (loss).” Amounts in “accumulated other comprehensive income (loss)” are reclassified into earnings in the “interest expense” caption when interest expense on the underlying borrowings is recognized.

***Property, Plant and Equipment***

These assets are recorded at cost and are depreciated using the straight-line method of depreciation over the estimated useful lives as follows:

	<u>Estimated Life</u>
Buildings and improvements .....	25 to 33-1/2 years
Building refurbishments .....	10 years
Machinery and equipment .....	7 to 12 years
Tools, dies and auxiliary equipment .....	3 to 8 years
Furniture and fixtures .....	3 to 12 years
Leasehold improvements .....	Shorter of life of asset or lease term

Major renewals and improvements of property, plant and equipment are capitalized, and repairs and maintenance costs are expensed as incurred.

***Goodwill, Other Intangible and Long-Lived Assets***

Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases. Goodwill and certain other intangible assets having indefinite lives are not amortized to earnings, but instead are subject to periodic testing for impairment. Intangible assets determined to have definite lives are amortized over their remaining useful lives.

Goodwill of a reporting unit is tested for impairment on an annual basis or between annual tests if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying amount. To the extent the carrying amount of a reporting unit exceeds the fair value of the reporting unit, we are required to perform a second step, as this is an indication that the reporting unit goodwill may be impaired. In this step, we compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation, in accordance with Statement of Financial Accounting Standards No. 141, “Business Combinations” (“SFAS 141”). The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

Intangible and other long-lived assets are reviewed for impairment whenever events such as product discontinuance, plant closures, product dispositions or other changes in circumstances indicate that the carrying amount may not be recoverable. In reviewing for impairment, we compare the carrying value of such assets with finite lives to the estimated undiscounted future cash flows expected from the use of the assets and their eventual disposition. When the estimated undiscounted future cash flows are less than their carrying amount, an impairment loss is recognized equal to the difference between the assets fair value and their carrying value.

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *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.

#### *Foreign Currency Translation*

Assets and liabilities are translated into U.S. dollars at year-end exchange rates, and revenues and expenses are translated at average exchange rates during the year. The resulting translation adjustments are recorded as a separate component of accumulated other comprehensive income (loss) and remains there until the underlying foreign operation is liquidated or substantially disposed of. Where the U.S. dollar is the functional currency, transaction gains or losses arising from the remeasurement of financial statements are recorded in the statement of operations under the caption "other income (expense)."

#### *Revenue Recognition*

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 actually 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.

#### *Selling, General and Administration Expenses*

Selling, general and administration expenses includes shipping costs and advertising, which is expensed as incurred. Shipping and handling charges, as well as freight to customers, are included in distribution expenses as part of selling, general and administration expenses.

#### *Deferred Financing Costs*

We have incurred costs in obtaining financing. These costs of \$9.9 million as of December 31, 2006 and 2005 were capitalized in other assets and are being amortized over the life of the related financing arrangements through 2009. As of December 31, 2006 and 2005, total accumulated amortization was \$7 million and \$5.4 million, respectively.

#### *Post-retirement Benefits other than Pensions*

The annual net post-retirement benefit liability and related expense under our benefit plans are determined on an actuarial basis. Benefits are determined primarily based upon employees' length of service.

#### *Income Taxes*

Income taxes are calculated using the asset and liability method in accordance with the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." Deferred tax assets and liabilities are determined based on the estimated future tax effects of temporary differences



**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

between the financial statement carrying amounts and the tax bases of assets and liabilities, as measured by the current enacted tax rates. The Company establishes valuation allowances against deferred tax assets when it is more likely than not that some portion or all of those deferred assets will not be realized. The valuation allowance is intended in part to provide for the uncertainty regarding the ultimate utilization of the Company's U.S. net operating loss carry forwards, U.S. capital loss carryovers, U.S. foreign tax credit carryovers, and foreign net operating loss carry forwards. Deferred tax expense (benefit) is the result of changes in the deferred tax asset and liability.

***Reporting of Comprehensive Income (Loss)***

Comprehensive income (loss) includes (a) net income, (b) the cumulative effect of translating balance sheets of foreign subsidiaries to U.S. dollars, (c) the effect of adjusting interest rate swaps to market, and (d) the recognition of the unfunded status of pension and post-retirement benefit plans as well as minimum pension liabilities. The last three are not included in the income statement and are reflected as adjustments to shareholder's equity.

***Net Earnings Per Common Share***

We present two calculations of earnings per common share. "Basic" earnings per common share equals net income divided by weighted average common shares outstanding during the period. "Diluted" earnings per common share equals net income divided by the sum of weighted average common shares outstanding during the period plus potentially dilutive common shares. Potentially dilutive common shares that are anti-dilutive are excluded from net earnings per common share. The following is a reconciliation of the shares used in calculating basic and dilutive net earnings per common share.

	<u>2006</u>	<u>2005</u> (In thousands)	<u>2004</u>
Weighted average common shares.....	18,284	19,508	19,331
Effect of potentially dilutive common shares ...	41	—	—
Weighted average common equivalent shares outstanding assuming dilution .....	18,325	19,508	19,331

The average shares listed below were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented.

	<u>2006</u>	<u>2005</u> (In thousands)	<u>2004</u>
Stock options and restricted shares .....	991	1,249	1,192
Convertible debentures .....	2,796	2,796	2,796

***Asbestos Litigation***

In evaluating our potential asbestos-related liability, it is the accounting policy of the Company to use an actuarial study that is prepared by a leading actuarial firm with expertise in assessing asbestos-related liabilities. We evaluate the estimate of the range of undiscounted liability to determine which amount to accrue. If there is no amount within the range of settlement payments that is more likely than any other, we record the low end of the range as the liability associated with future settlement payments. Legal costs are expensed as incurred.

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *Concentrations of Credit Risk*

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash investments and accounts receivable. We place our cash investments with high quality financial institutions and limit the amount of credit exposure to any one institution. Although we are directly affected by developments in the vehicle parts industry, management does not believe significant credit risk exists. With respect to accounts receivable, such receivables are primarily from warehouse distributors and major retailers in the automotive aftermarket industry located in the United States. We perform ongoing credit evaluations of our customers' financial conditions. Our five largest individual customers, including members of a marketing group, accounted for 51%, 52% and 50% of consolidated net sales in 2006, 2005 and 2004, respectively. Two individual customers accounted for 18% and 14%, respectively, of consolidated net sales in 2006, 18% and 15%, respectively, of consolidated net sales in 2005, and 17% and 14%, respectively, of consolidated net sales in 2004. Substantially all of the cash and cash equivalents, including foreign cash balances, at December 31, 2006 and 2005 were uninsured. Foreign cash balances at December 31, 2006 and 2005 were \$11.7 million and \$3 million, respectively.

#### *Recently Issued Accounting Pronouncements*

##### *Share-Based Payment*

Effective January 1, 2006, the Company adopted the provisions and accounts for stock-based compensation in accordance with 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. We have adopted SFAS 123R using a modified prospective application, under which prior periods are not revised for comparative purposes. 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 year ended December 31, 2006 was \$848,000 (\$516,100 net of tax) or \$0.03 per basic and diluted share. 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

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

open tax positions at the effective date. The Company is 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 fiscal years beginning after November 15, 2007, which for the Company is the year ending December 31, 2008. The Company is 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 funded status of their defined benefit pension or postretirement plans on the consolidated balance sheet 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 adopted the recognition and related disclosure provisions of SFAS No. 158, prospectively, on December 31, 2006. The adoption of SFAS 158 resulted in an increase to total assets of \$1.2 million, an increase to total liabilities of \$2.6 million, and a decrease to shareholders' equity of \$1.4 million. 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. The Company is presently evaluating the impact of the measurement date change, which is not expected to be material.

The incremental effect of applying SFAS No. 158 on individual line items in the consolidated balance sheet at December 31, 2006 was as follows (in thousands):

	<b>Before Application of SFAS No. 158</b>	<b>Adjustments</b>	<b>After Application of SFAS No. 158</b>
Prepaid expenses and other current assets (current) .....	\$ 7,861	\$ (16)	\$ 7,845
Other assets (pension, deferred income taxes - non-current).....	40,658	<u>1,216</u>	41,874
Total assets.....	638,892	<u>1,200</u>	640,092
Sundry payables and accrued expenses (pension, current).....	25,610	(1,100)	24,510
Pension and post-retirement medical benefits (non-current).....	47,964	<u>3,714</u>	51,678
Total liabilities .....	446,779	<u>2,614</u>	449,393
Accumulated other comprehensive income (loss) .....	4,955	<u>(1,414)</u>	3,541
Total liabilities and stockholders' equity .....	\$638,892	<u>\$1,200</u>	\$640,092

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *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. There was no impact of adopting SAB 108 to our consolidated financial position, results of operations and cash flows.

## **2. Restructuring and Integration Costs**

#### *Restructuring Costs*

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") in June 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 \$12.8 million as of December 31, 2006. As of December 31, 2006, the remaining restructuring accrual was \$1.1 million as of December 31, 2006. We expect to pay most of the remaining amount in 2007 and 2008.

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 years ended December 31, 2006 and 2005, termination benefits of \$0.2 million and \$2.3 million, respectively, have been charged to the restructuring accrual. As of December 31, 2006, the reserve balance for workforce reductions was \$0.5 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

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 in 2006, leaving the exit reserve balance for exit costs at \$0.6 million as of December 31, 2006.

Selected information relating to the restructuring costs included in the allocation of the cost to acquire DEM for the years ended December 31, 2006 and 2005 is as follows (in thousands):

	Workforce Reduction	Other Exit Costs	Total
Restructuring liability at December 31, 2004 .....	\$ 4,250	\$ 15,143	\$ 19,393
Cash payments during 2005 .....	(2,338)	(3,178)	(5,516)
Adjustments during 2005 .....	<u>(1,103)</u>	<u>(140)</u>	<u>(1,243)</u>
Restructuring liability as of December 31, 2005 .....	\$ 809	\$ 11,825	\$ 12,634
Cash payments during 2006 .....	(184)	(758)	(942)
Adjustments during 2006 .....	<u>(153)</u>	<u>(10,453)</u>	<u>(10,606)</u>
Restructuring liability as of December 31, 2006 .....	<u>\$ 472</u>	<u>\$ 614</u>	<u>\$ 1,086</u>

*Integration Expenses*

For the year ended December 31, 2006 and 2005, we incurred integration expenses of \$1.9 million and \$5.3 million, respectively. The 2006 amount primarily relates to the costs of moving our European and Puerto Rico 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 \$3.3 million integration expense. The remainder of the 2005 costs is primarily due to the DEM integration.

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. These operations will be moved to other manufacturing sites of the Company. The facility move and closure is planned to occur in a phased manner over the next 18-24 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 Company estimates these termination benefits will amount to approximately \$2 million which will be recognized as expense ratably over the requisite service period. The Company also expects to incur approximately \$2.4 million of various expenses to move the production assets, close the Puerto Rico facility, and relocate some employees. These expenses will be recognized as incurred. In 2006 we incurred expenses of \$0.4 million included above for one-time termination benefits.

Selected information relating to this exit activity is as follows (in thousands):

	Workforce Reduction	Other Exit Costs	Total
Exit activity liability at December 31, 2006 .....	\$ —	\$ —	\$ —
Amounts provided for during 2006 .....	387	35	422
Cash payments during 2006 .....	<u>—</u>	<u>—</u>	<u>—</u>
Exit activity liability at December 31, 2006 .....	<u>\$ 387</u>	<u>\$ 35</u>	<u>\$ 422</u>

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In December 2006, we divested a majority portion of our European Temperature Control business. The transaction involved the sale of all of our voting stock of our subsidiaries in Italy and France. The proceeds from the divestiture were approximately \$3.1 million, and the Company incurred a loss on divestiture of \$3.2 (included in earnings from continuing operations before taxes - other (expense) income, net). The major classes of assets and liabilities at the time of sale were as follows: accounts receivable of \$4 million, inventory of \$3.9 million, accounts payable of \$1.7 million, and accrued liabilities of \$0.8 million. The European Temperature Control business was previously included in our European segment.

**3. 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 or existing 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 were initially recorded as a prepaid asset and the related expense was recognized ratably over a 12-month period beginning in the month following the stocklift as an offset to sales. In the fourth quarter of 2004, we determined that it was a preferable accounting method to reflect the customer acquisition costs as a reduction to revenue when incurred.

**4. Sales of Receivables**

Prior to November 18, 2005, the Company entered into agreements to sell undivided interests in certain of its receivables to factoring companies, which in turn have the right to sell an undivided interest to a financial institution or other third parties. We entered these agreements at our discretion when we determined that the cost of factoring was less than the cost of servicing our receivables with existing debt. Pursuant to these agreements, we sold \$240.7 million and \$194.4 million of receivables during 2005 and 2004, respectively, and none in 2006. We retained no rights or interest, and had no obligations, with respect to the sold receivables. We do not service the receivables after the sale.

The sale of receivables was accounted for as a sale in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The sold receivables were removed from the balance sheet at the time of sale. The costs incurred in relation to the sale of receivables were \$3.4 million and \$2.4 million in 2005 and 2004, respectively, and are recorded in selling, general and administrative expense. Pursuant to an amendment to our revolving credit facility in November 2005, we are prohibited from accepting drafts under our customer draft programs after November 18, 2005.

**5. Inventories**

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
	(In thousands)	
Finished goods, net.....	\$ 169,183	\$ 182,567
Work in process, net.....	4,654	4,235
Raw materials, net.....	60,133	56,495
Total inventories, net.....	<u>\$ 233,970</u>	<u>\$ 243,297</u>

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. Property, Plant and Equipment**

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
	(In thousands)	
Land, buildings and improvements .....	\$ 71,147	\$ 70,748
Machinery and equipment .....	133,022	136,010
Tools, dies and auxiliary equipment.....	24,270	22,447
Furniture and fixtures .....	29,255	28,634
Leasehold improvements.....	7,595	7,485
Construction in progress.....	5,732	6,552
	<u>271,021</u>	<u>271,876</u>
Less accumulated depreciation.....	190,930	186,071
Total property, plant and equipment, net.....	<u>\$ 80,091</u>	<u>\$ 85,805</u>

Depreciation expense was \$13.4 million, \$15 million and \$16.8 million for 2006, 2005 and 2004, respectively.

**7. Goodwill and other Intangible Assets**

We test for impairment of our remaining goodwill at least annually. Under SFAS No. 142, "Goodwill and Other Intangible Assets," we completed our annual impairment test of goodwill as of December 31, 2006 and 2005, respectively, and determined that our goodwill was not impaired.

For 2004, after completion of our annual impairment test of goodwill, we determined that the carrying amounts of two of our reporting units exceeded the corresponding fair values, which were determined based on the discounted estimated future cash flows of the reporting units, the Company's weighted average cost of capital and market multiples. As a result, we recorded an impairment loss in the fourth quarter of 2004 of our remaining goodwill in our Temperature Control and European segments of \$4.8 million and \$1.6 million, respectively.

The changes in the carrying value of goodwill for our segments during the two years ended December 31, 2006 are as follows (in thousands):

	<u>Engine</u>	<u>Temperature</u>		<u>Total</u>
	<u>Management</u>	<u>Control</u>	<u>Europe</u>	
Balance as of December 31, 2004.....	\$ 50,337	\$ —	\$ —	\$ 50,337
Purchase accounting adjustments (Note 2) .....	(1,243)	—	—	(1,243)
Balance as of December 31, 2005.....	\$ 49,094	\$ —	\$ —	\$ 49,094
Purchase accounting adjustments (Note 2) .....	(10,606)	—	—	(10,606)
Balance as of December 31, 2006.....	<u>\$ 38,488</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 38,488</u>

In connection with the acquisition of DEM, we completed the purchase price allocation in June 2004. As a result, goodwill was reduced by \$15.3 million in 2004 comprised of \$16.1 million reclassified to other intangible assets based on a fair market valuation and \$0.8 million increase related to the acquired inventory. During 2006 and 2005, goodwill was reduced \$10.6 million and \$1.2 million, respectively, based on a reduction in the restructuring cost estimate that had been established in purchase accounting. (See Note 2)

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Other Intangible Assets***

Other intangibles assets include computer software. Computer software, net of amortization, was \$4.5 million and \$3.9 million as of December 31, 2006 and 2005, respectively. Computer software is amortized over its estimated useful life of 3 to 10 years. Amortization expense for computer software was \$1.0 million, \$0.8 million and \$1.5 million for the years ended December 31, 2006, 2005 and 2004, respectively.

***Acquired Intangible Assets***

Acquired identifiable intangible assets associated with the acquisition of DEM, as of December 31, 2006 and 2005, consist of (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Gross customer relationships.....	\$ 10,000	\$ 10,000
Trademarks and trade names .....	6,100	6,100
	<u>16,100</u>	<u>16,100</u>
Less accumulated amortization(1).....	2,778	1,667
Net .....	<u>\$ 13,322</u>	<u>\$ 14,433</u>

(1) Applies to the gross customer relationships.

Of the total purchase price, \$16.1 million was allocated to intangible assets consisting of customer relationships and trademarks and trade names; \$10 million was assigned to customer relationships and will be amortized on a straight-line basis over the estimated useful life of 10 years; and the remaining \$6.1 million of acquired intangible assets was assigned to trademarks and trade names which is not subject to amortization as they were determined to have indefinite useful lives. Amortization expense for acquired intangible assets was \$1.1 million, \$1.1 million and \$0.6 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Estimated amortization expense for the next five years is \$1.1 million in each year during 2007 through 2011.

**8. Other Assets**

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
	<u>(In thousands)</u>	
Equity in joint ventures .....	\$ 2,483	\$ 2,014
Deferred income taxes, net (Note 16) .....	24,434	26,567
Deferred financing costs, net .....	2,897	4,558
Other .....	12,060	11,008
Total other assets, net.....	<u>\$ 41,874</u>	<u>\$ 44,147</u>

Included in the above caption "Other" is a preferred stock investment of \$1.5 million in a customer, which is carried at cost. Net sales to this customer amounted to \$37.4 million, \$47.8 million and \$65.3 million in 2006, 2005 and 2004, respectively.



**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Credit Facilities and Long-Term Debt**

Total debt consists of (in thousands):

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<u>Current</u>		
Revolving credit facilities (1) .....	\$ 139,799	\$ 149,236
Current portion of mortgage loan.....	542	542
	140,341	149,778
<u>Long-term Debt</u>		
6.75% convertible subordinated debentures .....	90,000	90,000
Mortgage loan .....	8,416	8,912
Other .....	105	179
Less current portion of long-term debt .....	542	542
	97,979	98,549
 Total debt.....	 \$ 238,320	 \$ 248,327

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

Maturities of long-term debt during the five years ending December 31, 2007 through 2011 are \$0.5 million, \$0.6 million, \$90.6 million, \$0.6 million and \$0.7 million, respectively.

The Company had deferred financing cost of \$2.9 million and \$4.5 million as of December 31, 2006 and 2005, 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 in the amount of \$1.7 million in 2007, \$0.7 million in 2008, \$0.2 million in 2009 and \$0.3 million for the period 2010-2018.

***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 \$82.5 million available for us to borrow pursuant to the formula at December 31, 2006. Our credit agreement also permits dividends and distributions by us provided specific conditions are met.

At December 31, 2006, the interest rate on the Company's revolving credit facility was 7.8%. 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, was \$133.3 million at December 31, 2006. 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

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

#### *Revolving Credit Facility—Europe*

Our European subsidiary has a revolving credit facility. The amount of short-term bank borrowings outstanding under this facility was \$6.5 million and \$7 million at December 31, 2006 and 2005, respectively. The weighted average interest rates on these borrowings at December 31, 2006 and 2005 were 6.3% and 6.5%, respectively. At December 31, 2006, there was an additional \$0.8 million available for our European subsidiary to borrow.

#### *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 on July 15, 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 5.5% maturing in July 2018. The mortgage loan is secured by a building and related property.

### **10. Interest Rate Swap Agreements**

We do not enter into financial instruments for trading or speculative purposes. The principal financial instruments we have used in the past for cash flow hedging purposes are interest rate swaps. We have entered into interest rate swap agreements to manage our exposure to interest rate changes. The swaps effectively convert a portion of our variable rate debt under the revolving credit facility to a fixed rate, without exchanging the notional principal amounts.

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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. As of December 31, 2005 we had recorded a liability of \$0.2 million associated therewith. The net offset was recorded in accumulated other comprehensive income. Following the maturity of the swap agreement, none of these amounts remain outstanding as of December 31, 2006.

If, at any time, the swaps were determined to be ineffective, in whole or in part, due to changes in the interest rate swap or underlying debt agreements, the fair value of the portion of the interest rate swap determined to be ineffective would have been recognized as gain or loss in the statement of operations in the “interest expense” caption for the applicable period. There has not been any gain or loss reported in the statement of operations during the years ending December 31, 2006, 2005 or 2004.

**11. Stockholders’ Equity**

We have authority to issue 500,000 shares of preferred stock, \$20 par value, and our Board of Directors is vested with the authority to establish and designate any series of preferred, to fix the number of shares therein and the variations in relative rights as between each series. In December 1995, our Board of Directors established a new series of preferred shares designated as Series A Participating Preferred Stock. The number of shares constituting the Series A Preferred Stock is 30,000. The Series A Preferred Stock is designed to participate in dividends, ranks senior to our common stock as to dividends and liquidation rights and has voting rights. Each share of the Series A Preferred Stock shall entitle the holder to one thousand votes on all matters submitted to a vote of the stockholders of the Company. No such shares were outstanding at December 31, 2006.

As of December 31, 2006, we have Board authorization to repurchase additional shares at a maximum cost of \$1.7 million. During 2006, we did not repurchase any shares of our common stock.

Accumulated other comprehensive income is comprised of the following (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Foreign currency translation adjustments .....	\$ 8,382	\$ 7,082
Unrealized gain on interest rate swap agreement, net of tax.....	—	298
Initial adoption of FASB Statement No. 158, net of income taxes	(1,414)	—
Minimum pension liability.....	(3,427)	(3,222)
Total accumulated other comprehensive income.....	<u>\$ 3,541</u>	<u>\$ 4,158</u>

In January 1996, our Board of Directors adopted a Shareholder Rights Plan (“Rights Plan”). Under the Rights Plan, the Board declared a dividend of one Preferred Share Purchase Right (“Right”) for each of our outstanding common shares. The dividend was payable on March 1, 1996 to the shareholders of record as of February 15, 1996. The Rights were attached to and automatically traded with the outstanding shares of our common stock. The Rights were exercisable only upon the occurrence of certain events. In February 2006, the Rights Plan expired according to its stated terms.

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### 12. 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 December 31, 2006, under our stock option plans, there were an aggregate of (a) 1,030,948 shares of common stock authorized for grants, (b) 990,898 shares of common stock granted, and (c) no shares of common stock available for future grants. At December 31, 2006, under our 2006 Omnibus Incentive Plan, there were an aggregate of (a) 700,000 shares of common stock authorized for grants, (b) 94,100 shares of common stock granted, and (c) 605,900 shares of common stock available for future grants.

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 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

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

January 1, 2006. Stock-based compensation expense was \$848,000 (\$516,100 net of tax) or \$0.03 per basic and diluted share for the year ended December 31, 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):

	Year Ended December 31 2005	Year Ended December 31 2004
Net losses as reported.....	\$ (3,545)	\$ (14,380)
Less: Stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects.....	678	452
Pro forma net losses .....	<u>\$ (4,223)</u>	<u>\$ (14,832)</u>
Losses per share:		
Basic – as reported.....	<u>\$ (0.18)</u>	<u>\$ (0.74)</u>
Basic – pro forma .....	<u>\$ (0.22)</u>	<u>\$ (0.77)</u>
Diluted – as reported.....	<u>\$ (0.18)</u>	<u>\$ (0.74)</u>
Diluted – pro forma .....	<u>\$ (0.22)</u>	<u>\$ (0.77)</u>

*Stock Option Grants*

There were no stock options granted in the year ended December 31, 2006 and options to purchase 280,500 shares of common stock were granted in the year ended December 31, 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 year'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 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 was computed using the Black Scholes option pricing model with the following assumptions applicable to each remaining unvested annual grant:

<u>Year of Grant:</u>	<u>2005</u>	<u>2004</u>
Expected option life .....	3.9 years	3.9 years
Expected stock volatility .....	39.1%	38.6%
Expected dividend yield .....	3.4%	2.7%
Risk-free rate .....	4.0%	3.6%
Fair value of option .....	\$2.72	\$3.46

The expected term of the options is based on evaluations of historical and expected future employee exercise behavior. The risk-free interest rate was based on the US Treasury rates at the date of grant with

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

maturity dates approximately equal to the expected life at the grant date. Volatility was based on historical volatility of the Company's common stock.

The following is a summary of the changes in outstanding stock options for the year ended December 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)
Outstanding at beginning of year .....	1,249,226	\$ 14.42	6.2
Expired .....	(180,665)	\$ 20.43	0
Exercised .....	( 70,038)	\$ 10.55	0
Forfeited, Other .....	(7,625)	\$ 12.76	5.8
<hr/>			
Outstanding at end of year .....	990,898	\$ 13.61	5.1
<hr/>			
Options exercisable at end of year .....	861,148	\$ 13.91	4.6

The aggregate intrinsic value of all outstanding stock options was \$1.9 million, of which \$1.4 million relates to options that are exercisable. The total intrinsic value of options exercised was \$0.3 million, \$0 million and \$0.7 million during the years ended December 31, 2006, 2005 and 2004, respectively.

The following is a summary of the changes in non-vested stock options for the year ended December 31, 2006:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at January 1, 2006 .....	494,426	\$ 3.04
Forfeitures .....	5,000	\$ 2.83
Vested .....	359,676	\$ 3.16
Non-vested shares at December 31, 2006 .....	<u>129,750</u>	<u>\$ 2.72</u>

Stock option-based compensation expense in 2006 was \$547,400 (\$333,100 net of tax), including \$264,700 for unvested options. As of December 31, 2006, we have \$88,200 of unrecognized compensation cost related to non-vested stock options granted, which will be recognized over a weighted-average period of 0.25 years.

*Restricted and Performance Stock Grants*

Under our 2006 Omnibus Incentive Plan, the Company is authorized to issue 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

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 year ended December 31, 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 year ended December 31, 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 \$164,200 (\$99,900 net of tax) and \$0 for the year ended December 31, 2006 and 2005, respectively. The unamortized compensation expense related to the Company's restricted and performance-based shares was \$506,200 at December 31, 2006 and is expected to be recognized over a weighted average period of 2.3 and 0.3 years for employees and directors, respectively.

The Company's restricted and performance-based share activity was as follows for the year ended December 31, 2006:

	Shares	Weighted Average Grant Date Fair Value Per Share
Balance at January 1, 2006 .....	—	—
Granted .....	95,225	\$ 7.21
Vested .....	200	\$ 7.84
Forfeited .....	1,250	\$ 6.90
Balance at December 31, 2006 .....	93,775	\$ 7.21

The weighted-average grant date fair value of restricted and performance-based shares granted during the year ended December 31, 2006 was \$676,600, or \$7.21 per share. No restricted or performance-based shares were authorized, granted, outstanding or vested during the years ended December 31, 2005 and 2004.

**13. Retirement Benefit Plans**

As discussed in Note 1, the Company adopted the provisions of SFAS No. 158 on December 31, 2006. The adoption related to retirement benefit plans resulted in a decrease to total assets of \$0.1 million, a decrease to total liabilities \$0.5 million, and an increase to shareholders' equity of \$0.4 million. 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. The Company is presently evaluating the impact of the measurement date change, which is not expected to be material.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We had a defined benefit pension plan covering certain former employees of our former brake business. During 2002, a partial settlement of the plan occurred in conjunction with the purchase of non-participating annuity contracts for plan members. The final settlement under the plan has occurred as the remaining assets under the plan have been distributed. All pension benefit obligations have been satisfied, the projected benefit obligation under the plan was \$0, and the plan was closed out.

The following table represents a reconciliation of the beginning and ending benefit obligation, the fair value of plan assets and the funded status of the plan (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
<b>Change in Benefit Obligation:</b>		
Benefit obligation at beginning of year.....	\$ —	\$ —
Interest cost .....	—	—
Actuarial loss .....	—	—
Settlement .....	—	—
Benefits paid .....	—	—
Benefit obligation at end of year.....	<u>\$ —</u>	<u>\$ —</u>
<b>Change in Plan Assets:</b>		
Fair value of plan assets at beginning of year.....	\$ 587	\$ 594
Settlement .....	(610)	—
Actual return on plan assets .....	23	(7)
Benefits paid .....	—	—
Fair value of plan assets at end of year .....	<u>\$ 0</u>	<u>\$ 587</u>
<b>Funded status</b> .....	<u>0</u>	<u>\$ 587</u>
Unrecognized net actuarial loss .....	0	66
Net amount recognized (prepaid benefit cost) .....	<u>\$ 0</u>	<u>\$ 653</u>

Weighted average assumptions are as follows (in thousands):

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rates.....	N/A	N/A	N/A
Expected long-term rate of return on assets.....	N/A	N/A	N/A

Components of net periodic (benefit) cost follow (in thousands):

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Interest cost .....	\$ —	\$ —	\$ —
Return on assets .....	—	—	—
Settlement .....	—	—	—
Recognized actuarial (gain) loss .....	1	33	116
Net periodic (benefit) cost .....	<u>\$ 1</u>	<u>\$ 33</u>	<u>\$ 116</u>



**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In addition, we participate in several multi-employer plans which provide defined benefits to substantially all unionized workers. The Multi-employer Pension Plan Amendments Act of 1980 imposes certain liabilities upon employers associated with multi-employer plans. The plan is administered by the Company, and contributions are determined in accordance with the provisions of a negotiated labor contract. We have not received information from the plans' administrators to determine our share, if any, of unfunded vested benefits.

We and certain of our subsidiaries also maintain various defined contribution plans, which include profit sharing and provide retirement benefits for other eligible employees. The provisions for retirement expense in connection with the plans are as follows (in thousands):

	<b>Multi- employer Plans</b>	<b>Defined Contribution and Other Plans</b>
Year ended December 31,		
2006 .....	\$ 445	\$ 3,804
2005 .....	434	3,759
2004 .....	454	3,980

We have an Employee Stock Ownership Plan and Trust ("ESOP") for employees who are not covered by a collective bargaining agreement. Employees were granted 118,500 shares, 114,500 shares, and 110,000 shares during 2006, 2005 and 2004, respectively, under the terms of the ESOP. These shares were issued directly from treasury stock.

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 its fiduciary duties. During 2006, we committed 118,500 shares to be released leaving 182,000 shares remaining in the trust. The provision for expense in connection with the ESOP was approximately \$1.2 million in 2006, \$1.3 million in 2005, and \$1.6 million in 2004.

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. Such contributions were \$83,000 in 2006, \$69,000 in 2005, and \$79,000 in 2004.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
	(In thousands)	
<b>Change in Benefit Obligation:</b>		
Benefit obligation at beginning of year.....	\$ 5,495	\$ 4,599
Service cost.....	393	394
Interest cost.....	284	255
Actuarial loss (gain).....	(530)	247
Benefit obligation at end of year.....	<u>\$ 5,642</u>	<u>\$ 5,495</u>
<b>Funded status</b> .....	(5,642)	(5,495)
Unrecognized prior service cost.....	690	801
Additional minimum pension liability.....	(1,029)	(1,435)
Unrecognized net actuarial loss.....	912	1,559
Net amount recognized (accrued benefit cost).....	<u>\$ (5,069)</u>	<u>\$ (4,570)</u>

Components of net periodic benefit cost follow (in thousands):

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Service cost.....	\$ 393	\$ 394	\$ 355
Interest cost.....	284	255	232
Amortization of prior service cost.....	111	110	111
Amortization of unrecognized loss.....	117	118	128
Net periodic benefit cost.....	<u>\$ 905</u>	<u>\$ 877</u>	<u>\$ 826</u>

Actuarial assumptions used to determine costs and benefit obligations are as follows:

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rates.....	5.75%	5.50%	5.75%
Salary increase.....	4%	4%	4%

The following SERP benefit payments are expected to be paid (in thousands):

	<u>Benefits</u>
2007.....	\$ 0
2008.....	351
2009.....	351
2010.....	351
2011.....	351
Years 2012 - 2016.....	1,754

The estimated net loss and prior service cost for the plan that is expected to be amortized from accumulated other comprehensive income into pension costs during 2007 are \$0.1 million and \$0.1 million, respectively.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Our UK pension plan is comprised of a defined benefit plan and a defined contribution plan. Effective April 1, 2001, the defined benefit plan was closed to new entrants and existing active members ceased accruing any further benefits.

The following table represents a reconciliation of the beginning and ending benefit obligation and the funded status of our UK defined benefit plan:

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
	<b>(In thousands)</b>	
<b>Change in Benefit Obligation:</b>		
Benefit obligation at beginning of year.....	\$ 2,886	\$ 3,412
Service cost.....	—	—
Interest cost.....	168	157
Actuarial loss.....	—	(216)
Benefits paid.....	(125)	(121)
Translation adjustment.....	381	(346)
Benefit obligation at end of year.....	<u>\$ 3,310</u>	<u>\$ 2,886</u>
<b>Change in Plan Assets:</b>		
Fair value of plan assets at beginning of year.....	\$ 2,678	\$ 2,353
Settlement.....	94	109
Actual return on plan assets.....	288	587
Benefits paid.....	(125)	(121)
Expenses.....	—	(12)
Translation adjustment.....	353	(238)
Fair value of plan assets at end of year.....	<u>\$ 3,288</u>	<u>\$ 2,678</u>
<b>Funded status.....</b>	<b>(22)</b>	<b>(208)</b>
Unrecognized prior service cost.....	—	—
Additional minimum pension liability.....	(1,974)	(2,380)
Unrecognized net actuarial loss.....	—	—
Net amount recognized (accrued benefit cost).....	<u>\$ (1,996)</u>	<u>\$ (2,588)</u>

Amounts recognized in the consolidated balance sheet consist of (in thousands):

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
Current liabilities.....	\$ —	\$ (208)
Non-current liabilities.....	(22)	—
Accumulated other comprehensive loss.....	(1,974)	(2,380)
Net amount recognized.....	<u>\$ (1,996)</u>	<u>\$ (2,588)</u>

Amounts recognized in accumulated other comprehensive loss consist of (in thousands):

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
Net actuarial (gain) loss.....	\$ —	\$ —
Prior service cost (credit).....	22	208
Additional minimum pension liability.....	1,974	2,380
Net amount recognized.....	<u>\$ 1,996</u>	<u>\$ 2,588</u>

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Information for the UK pension plan with accumulated benefit obligation in excess of plan assets (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Projected benefit obligation .....	\$ 3,310	\$ 2,886
Accumulated benefit obligation .....	\$ 3,310	\$ 2,886
Fair value of plan assets .....	\$ 3,288	\$ 2,678

Components of net periodic benefit cost follow (in thousands):

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Service cost .....	\$ —	\$ —	\$ —
Interest cost .....	168	157	171
Amortization of transition obligation .....	—	—	—
Amortization of prior service cost .....	—	—	—
Amortization of net actuarial loss .....	—	—	—
Recognized actuarial (gain) loss .....	(196)	(145)	(150)
Net periodic benefit cost .....	<u>\$ (28)</u>	<u>\$ 12</u>	<u>\$ 21</u>

Actuarial assumptions used to determine costs and benefit obligations are as follows:

	<u>December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Discount rates .....	5.23%	5.23%	5.23%
Inflation .....	3.00%	3.00%	2.97%

The UK pension plan's weighted-average asset allocation by asset category are as follows:

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Equity securities .....	70%	78%
Bonds .....	14%	20%
Property .....	16%	0%
Cash .....	0%	2%
	<u>100%</u>	<u>100%</u>

The return on plan assets for 2006 was approximately 9.8%. The return on plan assets for 2005 was approximately 28%.

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

	<u><b>Pension Benefits</b></u>
2007.....	\$ 98
2008.....	118
2009.....	137
2010.....	157
2011.....	176
Years 2012 - 2016 .....	\$ 1,175

The provision for retirement expense in connection with the UK defined contribution plan is as follows (in thousands):

	<u><b>Defined Contribution Plan</b></u>
Year ended December 31,	
2006 .....	\$ 289
2005 .....	305
2004 .....	313

**14. Post-retirement Medical Benefits**

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 participants hired after 1995 are no longer eligible. In addition, 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 related to changes made to our plan which included the above eligibility restriction. The curtailment accounting required us to recognize 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. In January 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 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 \$6.8 million.

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (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.

As discussed in Note 1, the Company adopted the provisions of SFAS No. 158 on December 31, 2006. The adoption related to post-retirement medical benefit plans resulted in an increase to total assets of \$1.3 million, an increase to total liabilities \$3.1 million, and a decrease to shareholders' equity of \$1.9 million. 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. The Company is presently evaluating the impact of the measurement date change, which is not expected to be material.

The following table represents a reconciliation of the beginning and ending benefit obligation and the funded status of the plan (in thousands):

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
Benefit obligation at beginning of year.....	\$ 35,302	\$ 46,960
Service cost.....	807	2,924
Interest cost.....	2,050	2,330
Amendments.....	—	(20,667)
Actuarial loss.....	953	4,749
Benefits paid.....	(920)	(994)
Benefit obligation at end of year.....	<u>\$ 38,192</u>	<u>\$ 35,302</u>
Funded status.....	<u>\$ (38,192)</u>	<u>\$ (35,302)</u>
Unrecognized transition obligation.....	—	34
Unrecognized prior service costs.....	—	(14,334)
Unrecognized net actuarial loss.....	—	15,114
Accrued benefit cost.....	<u><u>\$ (38,192)</u></u>	<u><u>\$ (34,488)</u></u>

Components of net periodic benefit cost following (in thousands):

	<b>December 31</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Service cost.....	\$ 807	\$ 2,924	\$ 3,486
Interest cost.....	2,050	2,330	2,389
Amortization of transition obligation.....	4	30	42
Amortization of prior service cost.....	(2,868)	(1,190)	124
Amortization of net actuarial loss.....	—	6	5
Recognized actuarial (gain) loss.....	<u>1,481</u>	<u>1,056</u>	<u>663</u>
Net periodic benefit cost.....	<u>\$ 1,474</u>	<u>\$ 5,156</u>	<u>\$ 6,709</u>
SFAS 106 curtailment gain.....	—	(3,842)	—
Total benefit cost.....	<u><u>\$ 1,474</u></u>	<u><u>\$ 1,314</u></u>	<u><u>\$ 6,709</u></u>

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Actuarial assumptions used to determine costs and benefit obligations are as follows:

	<b>December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Discount rate .....	5.75%	5.50%	5.75%
Current medical cost trend rate .....	9%	9%	10%
Current dental cost trend .....	5%	5%	5%
Ultimate medical cost trend rate .....	5%	5%	5%
Year trend rate declines to ultimate .....	2011	2010	2009

Our measurement date for this plan is December 31.

The following benefit payments which reflect expected future service, as appropriate, are expected to be paid (in thousands):

	<b>Net Post- retirement Benefits</b>
2007 .....	\$ 997
2008 .....	1,080
2009 .....	1,181
2010 .....	1,292
2011 .....	1,385
Years 2012 – 2016 .....	\$ 9,273

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2006 (in thousands):

	<b>1-Percentage- Point Increase</b>	<b>1-Percentage- Point Decrease</b>
Effect on total of service and interest cost components .....	\$ 565	\$ (453)
Effect on post retirement benefit obligation .....	\$ 6,762	\$ (5,477)

The estimated net loss and prior service cost (credit) for the plan that is expected to be amortized from accumulated other comprehensive income into post-retirement medical benefits cost during 2007 are \$1.2 million and (\$2.9) million, respectively.

**15. Other Income (Expense), Net**

	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
	<b>(In thousands)</b>		
Interest and dividend income .....	\$ 498	\$ 311	\$ 615
Gain on early retirement of debt .....	—	1,258	—
Income from joint ventures .....	915	956	753
Loss on divestiture of European Temperature Control operations .....	(3,209)	—	—
Gain (loss) on disposal of property, plant and equipment .....	(71)	160	—
(Loss) gain on foreign exchange .....	646	(768)	731
Other income – net .....	838	731	762
Total other income (expense), net .....	<u>\$ (383)</u>	<u>\$ 2,648</u>	<u>\$ 2,861</u>

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**16. Income Taxes**

The income tax provision (benefit) consists of the following (in thousands):

	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Current:			
Domestic .....	\$ 968	\$ 233	\$ (2,476)
Foreign.....	2,135	2,137	4,022
Total Current.....	<u>3,103</u>	<u>2,370</u>	<u>1,546</u>
Deferred:			
Domestic.....	3,416	(1,074)	(4,558)
Foreign.....	(25)	127	(667)
Total Deferred.....	<u>3,391</u>	<u>(947)</u>	<u>(5,225)</u>
Total income tax provision (benefit).....	<u>\$ 6,494</u>	<u>\$ 1,423</u>	<u>\$ (3,679)</u>

We have not provided for U.S. income taxes on the undistributed earnings of our foreign subsidiaries that are deferred from U.S. income taxation and that we intend to be permanently reinvested. The Company has provided for U.S. income tax regarding those undistributed earnings of our foreign subsidiaries subject to current taxation under Subpart F of the Internal Revenue Code. Cumulative undistributed earnings of foreign subsidiaries on which no U.S. income tax has been provided were \$35.9 million at the end of 2006, \$36.1 million at the end of 2005 and \$28.8 million at the end of 2004.

Earnings before income taxes for foreign operations (excluding Puerto Rico) amounted to approximately \$6.6 million, \$6.8 million and \$6.8 million in 2006, 2005 and 2004, respectively. Prior to 2006, U.S. income taxes on the earnings of the Puerto Rican subsidiary were largely eligible for tax credits against such U.S. income taxes. During 2006, such earnings became fully subject to U.S. income taxes. Such earnings are partially exempt from Puerto Rican income taxes under a tax exemption grant expiring in 2016.

Reconciliations between taxes at the United States federal income tax rate and taxes at our effective income tax rate on earnings from continuing operations before income taxes are as follows:

	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
U.S. federal income tax rate of 35% .....	\$ 5,480	\$ (121)	\$ (4,405)
Increase (decrease) in tax rate resulting from:			
State and local income taxes, net of federal income tax benefit.....	33	(121)	(361)
State tax credits.....	8	(535)	—
Non-deductible items, net.....	246	241	174
Impact on deferred tax assets, Puerto Rico.....	(1,146)	—	—
Income (benefit) taxes attributable to foreign income.....	(2)	(1,115)	1,095
Change in valuation allowance.....	1,875	3,074	(182)
Provision (benefit) for income taxes.....	<u>\$ 6,494</u>	<u>\$ 1,423</u>	<u>\$ (3,679)</u>



**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following is a summary of the components of the net deferred tax assets and liabilities recognized in the accompanying consolidated balance sheets (in thousands):

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
Deferred tax assets:		
Inventories .....	\$ 9,922	\$ 8,701
Allowance for customer returns.....	7,285	8,298
Post-retirement benefits .....	13,261	12,889
Allowance for doubtful accounts.....	3,495	3,375
Accrued salaries and benefits.....	9,672	5,596
Net operating loss, capital loss and tax credit carry forwards .....	21,136	24,928
Goodwill .....	1,512	2,458
Accrued asbestos liabilities.....	8,691	10,703
Other .....	7,194	7,142
	<u>82,168</u>	<u>84,090</u>
Valuation allowance .....	<u>(28,006)</u>	<u>(26,131)</u>
Total.....	<u>\$ 54,162</u>	<u>\$ 57,959</u>
Deferred tax liabilities:		
Depreciation.....	\$ 4,743	\$ 7,270
Promotional costs .....	482	233
Goodwill.....	514	444
Restructuring costs.....	8,620	7,659
Other .....	1,358	1,705
Total.....	<u>15,717</u>	<u>17,311</u>
Net deferred tax assets .....	<u>\$ 38,445</u>	<u>\$ 40,648</u>

The current net deferred tax assets are \$14 million and \$14.1 million for 2006 and 2005, respectively. The non-current net deferred tax assets are \$24.4 million and \$26.6 million for 2006 and 2005, respectively. The tax valuation allowance was allocated to the current deferred tax assets in the amounts of \$10.3 million and \$9.1 million in 2006 and 2005, respectively. The long term tax deferred assets had a valuation allowance of \$17.7 million and \$17.1 million in 2006 and 2005, respectively.

We performed an assessment regarding the realization of the net deferred tax assets, which includes projecting future taxable income, and have increased the valuation allowance by \$1.9 million. The increase in the valuation allowance specifically applied to the capital loss realized in the US during the year as well as to European operating losses, given the uncertainty of realizing these benefits in the future. The valuation allowance is intended in part to provide for the uncertainty regarding the ultimate utilization of the Company's U.S. net operating and capital loss carryovers, state tax credit carryovers, U.S. foreign tax credit carryovers, foreign net operating loss carry forwards, and certain long lived deferred tax assets stemming mainly from accrued asbestos liabilities and post-retirement benefit obligations. Approximately \$21 million of the valuation allowance relates to US tax assets of \$53 million. Approximately \$97 million of taxable income will need to be generated to realize the deferred tax asset. We believe it is more likely than not that we will be able to generate this level of taxable income within 5 years based on the continuance of recently improved trends. As such, with regard to the remaining net deferred tax assets, we have determined that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the related benefits. However, if we are unable to

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

generate sufficient taxable income in the future through our operations, increases in the valuation allowance may be required.

At December 31, 2006, we have approximately \$32.6 million of domestic and foreign net operating loss carry forwards, of which \$21.3 million will expire between 2024 and 2025, with the remainder (foreign) having an indefinite carry forward period. We also have foreign tax credit carry forwards of approximately \$1.1 million that will expire between 2010 and 2012, a capital loss carry forward of approximately \$2.8 million that will expire in 2011 and an alternative minimum tax credit carry forward of approximately \$6.2 million, which has no expiration date.

**17. Industry Segment and Geographic Data**

Under the provisions of Statement of Financial Accounting Standards SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"), we have three reportable operating segments, which are the major product areas of the automotive aftermarket in which we compete. Engine Management consists primarily of ignition and emission parts, wire and cable, and fuel system parts. Temperature Control consists primarily of compressors, other air conditioning parts and heater parts. The third reportable operating segment is Europe, which consists of both Engine Management and Temperature Control reporting units.

The accounting policies of each segment are the same as those described in the summary of significant accounting policies (see Note 1). The following tables contain financial information for each reportable segment (in thousands):

	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Net sales:			
Engine Management .....	\$ 543,221	\$ 547,008	\$562,769
Temperature Control.....	211,102	229,226	210,094
Europe.....	47,044	43,423	40,651
Other .....	10,657	10,756	10,769
Total .....	<u>\$ 812,024</u>	<u>\$ 830,413</u>	<u>\$824,283</u>
Depreciation and amortization:			
Engine Management .....	\$ 9,893	\$ 9,992	\$ 10,921
Temperature Control .....	3,457	4,717	5,640
Europe .....	816	1,415	1,444
Other .....	1,320	1,232	1,008
Total .....	<u>\$ 15,486</u>	<u>\$ 17,356</u>	<u>\$ 19,013</u>
Operating profit (loss):			
Engine Management .....	\$ 41,249	\$ 19,338	\$ 24,549
Temperature Control .....	11,954	11,936	(2,114)
Europe .....	46	(572)	(2,034)
Other .....	(17,934)	(16,620)	(22,138)
Total .....	<u>\$ 35,315</u>	<u>\$ 14,082</u>	<u>\$ (1,737)</u>

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Investment in equity affiliates:			
Engine Management .....	\$ —	\$ —	\$ —
Temperature Control .....	—	—	—
Europe .....	201	(202)	(322)
Other .....	2,282	2,216	2,260
Total .....	<u>\$ 2,483</u>	<u>\$ 2,014</u>	<u>\$ 1,938</u>
Capital expenditures:			
Engine Management .....	\$ 7,481	\$ 7,511	\$ 7,513
Temperature Control .....	1,339	1,813	1,383
Europe .....	1,215	623	793
Other .....	45	10	85
Total .....	<u>\$ 10,080</u>	<u>\$ 9,957</u>	<u>\$ 9,774</u>
Total assets:			
Engine Management .....	\$ 430,158	\$ 438,116	\$ 429,631
Temperature Control .....	109,734	114,441	125,656
Europe .....	26,708	28,217	30,936
Other .....	73,492	72,270	70,346
Total .....	<u>\$ 640,092</u>	<u>\$ 653,044</u>	<u>\$ 656,569</u>

Reconciliation of segment operating profit (loss) to net income (loss):

	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Operating profit (loss) .....	\$ 35,315	\$ 14,082	\$ (1,737)
Other (expense) income .....	(383)	2,648	2,861
Interest expense .....	19,275	17,077	13,710
Earnings (loss) from continuing operations before taxes .....	15,657	(347)	(12,586)
Income tax expense (benefit) .....	6,494	1,423	(3,679)
Earnings (loss) from continuing operations .....	9,163	(1,770)	(8,907)
Discontinued operation, net of tax .....	248	(1,775)	(3,909)
Cumulative effect of accounting change, net of tax .....	—	—	(1,564)
Net earnings (loss) .....	<u>\$ 9,411</u>	<u>\$ (3,545)</u>	<u>\$ (14,380)</u>

Our five largest individual customers, including members of a marketing group, accounted for 51%, 52% and 50% of consolidated net sales in 2006, 2005 and 2004, respectively. These net sales were generated from our Engine Management and Temperature Control Segments.

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Other Adjustments consist of items pertaining to our corporate headquarters function, as well as our Canadian business unit that does not meet the criteria of a reportable operating segment under SFAS 131.

	<b>Revenue</b>		
	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
	<b>(In thousands)</b>		
United States .....	\$ 688,030	\$ 716,358	\$ 714,955
Canada .....	48,537	46,353	45,115
Europe .....	47,044	43,423	40,651
Other Foreign .....	28,413	24,279	23,562
Total .....	<u>\$ 812,024</u>	<u>\$ 830,413</u>	<u>\$ 824,283</u>

	<b>Long Lived Assets</b>		
	<b>Year Ended December 31,</b>		
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2004</u></b>
	<b>(In thousands)</b>		
United States .....	\$ 144,208	\$ 161,451	\$ 174,056
Europe .....	4,821	4,682	6,214
Canada .....	4,014	3,900	4,144
Other Foreign .....	778	754	785
Total .....	<u>\$ 153,821</u>	<u>\$ 170,787</u>	<u>\$ 185,199</u>

Revenues are attributed to countries based upon the location of the customer. Long lived assets are attributed to countries based upon the location of the assets.

**19. Fair Value of Financial Instruments**

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

***Cash and Cash Equivalents***

The carrying amount approximates fair value because of the short maturity of those instruments.

***Trade Accounts Receivable***

The carrying amount of trade receivables approximates fair value because of their short outstanding terms.

***Trade Accounts Payable***

The carrying amount of trade payables approximates fair value because of their short outstanding terms.

***Short Term Borrowings***

The carrying value of these borrowings equals fair market value because their interest rate reflects current market rates.

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Long-term Debt***

The fair value of our long-term debt is estimated based on quoted market prices or current rates offered to us for debt of the same remaining maturities.

***Interest Rate Swaps***

The fair value of our financial instruments is based on market quotes and represents the net amount required to terminate the position, taking into consideration market rates and counterparty credit risk.

The estimated fair values of our financial instruments are as follows (in thousands):

	<b><u>Carrying Amount</u></b>	<b><u>Fair Value</u></b>
<b>December 31, 2006</b>		
Cash and cash equivalents .....	\$ 22,348	\$ 22,348
Trade accounts receivable .....	183,664	183,664
Trade accounts payable.....	53,783	53,783
Short term borrowings .....	139,799	139,799
Long-term debt.....	98,521	94,584
Interest rate swaps.....	—	—
<b>December 31, 2005</b>		
Cash and cash equivalents .....	\$ 14,046	\$ 14,046
Trade accounts receivable .....	176,294	176,294
Trade accounts payable.....	52,535	52,535
Short term borrowings .....	149,236	149,236
Long-term debt.....	99,091	97,847
Interest rate swaps.....	496	496

**20. Commitments and Contingencies**

Total rent expense for the three years ended December 31, 2006 was as follows (in thousands):

	<b><u>Total</u></b>	<b><u>Real Estate</u></b>	<b><u>Other</u></b>
2006 .....	\$ 8,438	\$ 5,983	\$ 2,455
2005 .....	9,928	6,970	2,958
2004 .....	11,858	7,686	4,172

At December 31, 2006, we are obligated to make minimum rental payments through 2017, under operating leases, which are as follows (in thousands):

2007 .....	\$ 6,657
2008 .....	5,614
2009 .....	4,446
2010 .....	2,059
2011 .....	1,913
Thereafter .....	8,582
<b>Total .....</b>	<b><u>\$ 29,271</u></b>

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We also have lease and sub-lease agreements in place for various properties under our control. We expect to receive operating lease payments from lessees during the five years ending December 31, 2007 through 2012 of \$0.7 million, \$0.6 million, \$0.4 million, \$0.2 million, and \$0, respectively.

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 December 31, 2006 and 2005, we have accrued \$11.7 million and \$12.7 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 each of the years 2006, 2005 and 2004 were \$49.3 million, \$50.3 million and \$47.8 million, respectively.

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

	<b>December 31,</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>
Balance, beginning of period.....	\$ 12,701	\$ 13,194
Liabilities accrued for current year sales .....	49,259	50,273
Settlements of warranty claims.....	<u>(50,256)</u>	<u>(50,766)</u>
Balance, end of period .....	<u>\$ 11,704</u>	<u>\$ 12,701</u>

*Letters of Credit.* At December 31, 2006, we had outstanding letters of credit with certain vendors aggregating approximately \$2.2 million. The contract amount of the letters of credit is a reasonable estimate of their value as the value for each is fixed over the life of the commitment.

*Change of Control Arrangements.* We entered into Change in Control arrangements with two key officers. In the event of a Change of Control (as defined in the agreement), each executive will receive severance payments (as defined in the agreement) and certain other benefits.

*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, 2006, approximately 3,270 cases were outstanding for which we were responsible for any related liabilities. We expect the outstanding cases to increase gradually due to recent legislation in certain states mandating minimum medical criteria before a case can be heard. Since inception in September 2001 through February 28, 2007, the amounts paid for settled claims are approximately \$5 million. We do not have insurance coverage for the defense and indemnity costs associated with these claims.

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

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

We plan on performing a similar annual actuarial analysis 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, the Company was 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 filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments were originally scheduled for September 2006, however the court adjourned these proceedings until a later date to be determined. Subsequently, the judge initially assigned to the case excused himself, and a new judge has been assigned. 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.

*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.

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

21. Quarterly Financial Data Unit (Unaudited)

<b>2006:</b> <b>Quarter Ended</b>	<b>Dec. 31,</b> <b><u>2006</u></b>	<b>Sept. 30,</b> <b><u>2006</u></b>	<b>June 30,</b> <b><u>2006</u></b>	<b>Mar. 31,</b> <b><u>2006</u></b>
	<b>(In thousands, except per share amounts)</b>			
Net sales .....	\$ 169,019	\$ 203,755	\$ 229,174	\$ 210,076
Gross profit .....	45,952	49,332	56,706	53,231
(Loss) earnings from continuing operations .....	(1,473)	2,583	5,455	2,598
(Loss) income from discontinued operation, net of taxes .....	(355)	1,656	(289)	(764)
Net (loss) earnings .....	\$ (1,828)	\$ 4,239	\$ 5,166	\$ 1,834
Net (loss) earnings from continuing operations per common share:				
Basic .....	\$ (0.08)	\$ 0.14	\$ 0.30	\$ 0.14
Diluted .....	\$ (0.08)	\$ 0.14	\$ 0.30	\$ 0.14
Net (loss) earnings per common share:				
Basic .....	\$ (0.10)	\$ 0.23	\$ 0.28	\$ 0.10
Diluted .....	\$ (0.10)	\$ 0.23	\$ 0.28	\$ 0.10
<b>2005:</b> <b>Quarter Ended</b>	<b>Dec. 31,</b> <b><u>2005</u></b>	<b>Sept. 30,</b> <b><u>2005</u></b>	<b>June 30,</b> <b><u>2005</u></b>	<b>Mar. 31,</b> <b><u>2005</u></b>
	<b>(In thousands, except per share amounts)</b>			
Net sales .....	\$ 172,137	\$ 224,438	\$ 226,512	\$ 207,326
Gross profit .....	39,498	49,137	48,910	48,435
(Loss) earnings from continuing operations .....	(5,705)	4,163	(1,281)	1,053
Loss from discontinued operation, net of taxes .....	(535)	(449)	(384)	(407)
Net (loss) earnings .....	\$ (6,240)	\$ 3,714	\$ (1,665)	\$ 646
Net (loss) earnings from continuing operations per common share:				
Basic .....	\$ (0.29)	\$ 0.21	\$ (0.07)	\$ 0.05
Diluted .....	\$ (0.29)	\$ 0.21	\$ (0.07)	\$ 0.05
Net (loss) earnings per common share:				
Basic .....	\$ (0.32)	\$ 0.19	\$ (0.09)	\$ 0.03
Diluted .....	\$ (0.32)	\$ 0.19	\$ (0.09)	\$ 0.03



**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. 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. This evaluation also included consideration of our internal controls and procedures for the preparation of our financial statements as required under Section 404 of the Sarbanes-Oxley Act. 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) Management's Report on Internal Control Over Financial Reporting.

Pursuant to Section 404 of the Sarbanes-Oxley Act, as part of this Report we have furnished a report regarding our internal control over financial report as of December 31, 2006. The report is under the caption "Management's Report on Internal Control Over Financial Reporting" in "Item 8. Financial Statements and Supplementary Data", which report is incorporated herein by reference.

(c) Attestation Report of Independent Registered Public Accounting Firm.

Grant Thornton, our independent registered public accounting firm, has issued an opinion as to management's assessment and as to the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. The opinion is under the caption "Report of Independent Registered Public Accounting Firm—Internal Control Over Financial Reporting" in "Item 8. Financial Statements and Supplementary Data" for this attestation report, which is incorporated herein by reference.

(d) Changes in Internal Control Over Financial Reporting.

During the quarter ended December 31, 2006 and subsequent to that date, we have not made changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our 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.

**ITEM 9B. OTHER INFORMATION**

None.

## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item is incorporated herein by reference to the information in our Definitive Proxy Statement to be filed with the SEC in connection with our 2007 Annual Meeting of Stockholders (the "2007 Proxy Statement") set forth under the captions "Election of Directors," "Management Information," "Corporate Governance" and "Section 16(a) Beneficial Ownership Reporting Compliance."

### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item is incorporated herein by reference to the information in our 2007 Proxy Statement set forth under captions "Corporate Governance," "Executive Compensation and Related Information" and "Compensation and Management Development Committee Report."

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item is incorporated herein by reference to the information in our 2007 Proxy Statement set forth under the captions "Executive Compensation and Related Information" and "Security Ownership of Certain Beneficial Owners and Management."

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this Item is incorporated herein by reference to the information in our 2007 Proxy Statement set forth under the captions "Corporate Governance" and "Executive Compensation and Related Information."

### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item is incorporated herein by reference to the information in our 2007 Proxy Statement set forth under the captions "Audit and Non-Audit Fees."

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) The Index to Consolidated Financial Statements of the Registrant under Item 8 of this Report is incorporated herein by reference as the list of Financial Statements required as part of this Report.

(2) The following financial schedule and related report for the years 2006, 2005 and 2004 is submitted herewith:

Report of Independent Registered Public Accounting Firm on Schedule II

Schedule II - Valuation and Qualifying Accounts

All other schedules are omitted because they are not required, not applicable or the information is included in the financial statements or notes thereto.

(3) Exhibits.

The exhibit list in the Exhibit Index is incorporated by reference as the list of exhibits required as part of this Report.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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)**

/s/ Lawrence I. Sills  
Lawrence I. Sills  
Chairman, Chief Executive Officer and Director

/s/ James J. Burke  
James J. Burke  
Vice President, Finance and Chief Financial Officer

New York, New York  
March 16, 2007

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Lawrence I. Sills and James J. Burke, jointly and severally, as his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

March 16, 2007                    /s/ Lawrence I. Sills  
Lawrence I. Sills  
Chairman, Chief Executive Officer and Director  
(Principal Executive Officer)

March 16, 2007                    /s/ James J. Burke  
James J. Burke  
Vice President, Finance and Chief Financial Officer  
(Principal Financial Officer)

March 16, 2007                    /s/ Luc Gregoire  
Luc Gregoire  
Corporate Controller and  
Chief Accounting Officer

March 16, 2007            /s/ Robert M. Gerrity  
   Robert M. Gerrity, Director

March 16, 2007            /s/ Arthur S. Sills  
   Arthur S. Sills, Director

March 16, 2007            /s/ Peter J. Sills  
   Peter J. Sills, Director

March 16, 2007            /s/ Frederick D. Sturdivant  
   Frederick D. Sturdivant, Director

March 16, 2007            /s/ William H. Turner  
   William H. Turner, Director

March 16, 2007            /s/ Roger M. Widmann  
   Roger M. Widmann, Director

**STANDARD MOTOR PRODUCTS, INC.**  
**EXHIBIT INDEX**

**Exhibit  
Number**

- 2.1 Asset Purchase Agreement, dated as of February 7, 2003, by and among Dana Corporation, Automotive Controls Corp., BWD Automotive Corporation, Pacer Industries, Inc., Ristance Corporation, Engine Controls Distribution Services, Inc., as Sellers, and Standard Motor Products, Inc., as Buyer (incorporated by reference to the Company's Current Report on Form 8-K, filed on February 10, 2003).
- 3.1 Restated By-Laws, dated May 23, 1996, filed as an Exhibit of the Company's Annual Report on Form 10-K for the year ended December 31, 1996.
- 3.2 Restated Certificate of Incorporation, dated July 31, 1990, filed as an Exhibit to the Company's Annual Report on Form 10-K for the year ended December 31, 1990.
- 3.3 Certificate of Amendment of the Certificate of Incorporation, dated February 15, 1996, filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996.
- 4.1 Form of Subordinated Debenture Indenture (including form of convertible debenture) (incorporated by reference to Exhibit 4.1 to the Company's Amendment No. 2 to its Registration Statement on Form S-3 (Registration No. 333-79177), filed on July 20, 1999).
- 10.1 Employee Stock Ownership Plan and Trust, dated January 1, 1989 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1989).
- 10.2 Supplemental Executive Retirement Plan, dated August 15, 1994 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1994).
- 10.3 1996 Independent Outside Directors Stock Option Plan of Standard Motors Products, Inc. (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1996).
- 10.4 1994 Omnibus Stock Option Plan of Standard Motor Products, Inc., as amended (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 33-51565), filed on May 1, 1998).
- 10.5 1994 Omnibus Stock Option Plan of Standard Motor Products, Inc., as amended and restated, (incorporated by reference to the Company's Registration Statement on Form S-8 (Registration No. 333-59524), filed on April 25, 2001).
- 10.6 Supplemental Compensation Plan effective October 1, 2001 (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).
- 10.7 Change of Control Agreement, dated December 12, 2001, between Standard Motor Products, Inc. and John Gethin (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).

**STANDARD MOTOR PRODUCTS, INC.**  
**EXHIBIT INDEX**

**Exhibit  
Number**

- 10.8 Change of Control Agreement, dated December 12, 2001, between Standard Motor Products, Inc. and James Burke (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).
- 10.9 Amended and Restated Credit Agreement, dated as of February 7, 2003, among Standard Motor Products, Inc., as Borrower and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Current Report on Form 8-K filed on February 10, 2003).
- 10.10 Amendment No. 1 to Amended and Restated Credit Agreement, dated June 27, 2003, among Standard Motor Products, Inc., as Borrower and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
- 10.11 Amendment No. 2 to Amended and Restated Credit Agreement, dated March 11, 2004, among Standard Motor Products, Inc., as Borrower, and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Quarterly Report in Form 10-Q for the quarter ended March 31, 2004).
- 10.12 Amendment No. 3 to Amended and Restated Credit Agreement, dated August 11, 2004, among Standard Motor Products, Inc., as Borrower, and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Quarterly Report in Form 10-Q for the quarter ended September 30, 2004).
- 10.13 Waiver and Amendment No. 4 to Amended and Restated Credit Agreement, dated as of March 31, 2005, among Standard Motor Products, Inc., as Borrower, and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Annual Report in Form 10-K for the year ended December 31, 2004).
- 10.14 Waiver and Amendment No. 5 to Amended and Restated Credit Agreement, dated as of May 9, 2005, among Standard Motor Products, Inc., as Borrower, and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Quarterly Report in Form 10-Q for the quarter ended March 31, 2005).
- 10.15 Waiver and Amendment No. 6 to Amended and Restated Credit Agreement, dated as of November 4, 2005, among Standard Motor Products, Inc., as Borrower, and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Quarterly Report in Form 10-Q for the quarter ended September 30, 2005).
- 10.16 Consent and Amendment No. 7 to Amended and Restated Credit Agreement, dated as of December 29, 2005, among Standard Motor Products, Inc., as Borrower, and General Electric Capital Corp. and Bank of America, as Lenders (incorporated by reference to the Company's Current Report on Form 8-K filed on January 3, 2006).

## STANDARD MOTOR PRODUCTS, INC.

### EXHIBIT INDEX

**Exhibit  
Number**

- 10.17 Credit Agreement, dated as of December 29, 2005, among SMP Motor Products, Ltd., as Borrower, (incorporated by reference to the Company's Current Report on Form 8-K filed on January 3, 2006).
- 10.18 Repurchase and Prepayment Agreement, dated as of December 29, 2005, between Standard Motor Products, Inc., and Dana Corporation (incorporated by reference to the Company's Current Report on Form 8-K filed on January 3, 2006).
- 10.19 Amendment to the Standard Motor Products, Inc. Supplemental Compensation Plan, effective December 1, 2006.
- 10.20 Retention Bonus and Insurance Agreement, dated December 26, 2006, between Standard Motor Products, Inc. and John Gethin.
- 10.21 Retention Bonus and Insurance Agreement dated December 26, 2006, between Standard Motor Products, Inc. and James Burke.
- 21 List of Subsidiaries of Standard Motor Products, Inc.
- 23 Consent of Independent Registered Public Accounting Firm.
- 24 Power of Attorney (see signature page to Annual Report on Form 10-K).
- 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.



REPORT OF INDEPENDENT REGISTERED PUBLIC  
ACCOUNTING FIRM ON SCHEDULE

Stockholders and Board of Directors  
Standard Motor Products, Inc.

We have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated balance sheets of Standard Motor Products, Inc. and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 referred to in our report dated March 15, 2007, which is included in the annual report to security holders and incorporated by reference in Part II of this form. Our report on the consolidated financial statements includes explanatory paragraphs, relating to the application of Statement of Financial Accounting Standards No. 123(R) as of January 1, 2006 and No. 158 as of December 31, 2006. Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule II is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

New York, New York  
March 15, 2007

**STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES**

Schedule II - Valuation and Qualifying Accounts

Years ended December 31, 2006, 2005 and 2004

<u>Description</u>	Balance at beginning of year	<u>Additions</u>		<u>Deductions</u>	Balance at end of year
		Charged to costs and expenses	<u>Other</u>		
<u>Year ended December 31, 2006:</u>					
Allowance for doubtful accounts	\$ 7,527,000	\$ 405,000	\$ (382,000) (1)	\$ 239,000	\$ 7,311,000
Allowance for discounts	2,047,000	11,491,000	—	11,384,000	2,154,000
	<u>\$ 9,574,000</u>	<u>\$ 11,896,000</u>	<u>\$ (382,000) (1)</u>	<u>\$ 11,623,000</u>	<u>\$ 9,465,000</u>
Allowance for sales returns	<u>\$ 22,346,000</u>	<u>\$ 82,259,000</u>	<u>\$ (95,000) (1)</u>	<u>\$ 82,805,400</u>	<u>\$ 21,705,000</u>
Allowance for inventory valuation	<u>\$ 39,061,000</u>	<u>\$ 6,128,000</u>	<u>\$ (846,000) (1)</u>	<u>\$ 8,905,000</u>	<u>\$ 35,438,000</u>
<u>Year ended December 31, 2005:</u>					
Allowance for doubtful accounts	\$ 7,422,000	\$ 655,000	\$ —	\$ 550,000	\$ 7,527,000
Allowance for discounts	1,932,000	11,708,000	—	11,593,000	2,047,000
	<u>\$ 9,354,000</u>	<u>\$ 12,363,000</u>	<u>\$ —</u>	<u>\$ 12,143,000</u>	<u>\$ 9,574,000</u>
Allowance for sales returns	<u>\$ 23,127,000</u>	<u>\$ 83,872,000</u>	<u>\$ —</u>	<u>\$ 84,653,000</u>	<u>\$ 22,346,000</u>
Allowance for inventory valuation	<u>\$ 39,638,000</u>	<u>\$ 5,286,000</u>	<u>\$ —</u>	<u>\$ 5,863,000</u>	<u>\$ 39,061,000</u>
<u>Year ended December 31, 2004:</u>					
Allowance for doubtful accounts	\$ 3,009,000	\$ 404,000	\$ 5,163,000 (2)	\$ 1,154,000	\$ 7,422,000
Allowance for discounts	2,000,000	12,319,000	—	12,387,000	1,932,000
	<u>\$ 5,009,000</u>	<u>\$ 12,723,000</u>	<u>\$ 5,163,000</u>	<u>\$ 13,541,000</u>	<u>\$ 9,354,000</u>
Allowance for sales returns	<u>\$ 24,115,000</u>	<u>\$ 86,452,000</u>	<u>\$ 194,000 (3)</u>	<u>\$ 87,634,000</u>	<u>\$ 23,127,000</u>
Allowance for inventory valuation	<u>\$ 41,803,000</u>	<u>\$ 1,487,000</u>	<u>\$ 430,000 (3)</u>	<u>\$ 4,082,000</u>	<u>\$ 39,638,000</u>

(1) Allowances for divested companies.

(2) The Company previously presented the reserve for accounts receivable balances over 90 days past due as a reduction to the gross receivable balance instead of as part of the allowance for doubtful accounts. In the fourth quarter of 2004, the Company decided to record the \$5,163,000 of accounts receivable over 90 days past due as part of gross accounts receivable instead of as an offset to the allowance for doubtful accounts. There was no impact on the net accounts receivable recorded on the consolidated balance sheets.

(3) Allowances acquired through acquisitions.



**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Lawrence I. Sills, certify that:

1. I have reviewed this annual report on Form 10-K of Standard Motor Products, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 16, 2007

/s/ Lawrence I. Sills  
Lawrence I. Sills  
Chief Executive Officer

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James J. Burke, certify that:

1. I have reviewed this annual report on Form 10-K of Standard Motor Products, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 16, 2007

/s/ James J. Burke  
James J. Burke  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Standard Motor Products, Inc. (the "Company") on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Lawrence I. Sills, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Lawrence I. Sills  
Lawrence I. Sills  
Chief Executive Officer  
March 16, 2007

\*A signed original of this written statement required by Section 906 has been provided to Standard Motor Products, Inc. and will be retained by Standard Motor Products, Inc. and furnished to the Securities and Exchange Commission on its staff upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Standard Motor Products, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, James J. Burke, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ James J. Burke  
James J. Burke  
Chief Financial Officer  
March 16, 2007

\*A signed original of this written statement required by Section 906 has been provided to Standard Motor Products, Inc. and will be retained by Standard Motor Products, Inc. and furnished to the Securities and Exchange Commission on its staff upon request.

## Board of Directors

### Lawrence I. Sills

Chairman of the Board and CEO

### William H. Turner

Dean of the College of Business at  
Stony Brook University

### Robert M. Gerrity

Chairman of the Industrial Group of  
Glencoe Capital

### Arthur S. Sills

Retired Educator and Administrator

### Peter J. Sills

Author

### Frederick D. Sturdivant

Visiting Professor at Warrington College  
of Business at University of Florida

### Richard S. Ward

Retired Executive Vice President and  
General Counsel of ITT Corporation

### Roger M. Widmann

Retired Chairman of the Board of Lydall, Inc



## Corporate Officers

### Office of Chief Executive

#### Lawrence I. Sills

Chairman of the Board and CEO

#### John P. Gethin

President and Chief Operating Officer

#### James J. Burke

Vice President Finance and  
Chief Financial Officer

### Executive Officers

#### Carmine J. Broccole

Vice President  
General Counsel and Secretary

#### Dale Burks

Vice President  
Temperature Control Division

#### Robert Kimbro

Vice President  
Distribution Sales

#### Ray Nicholas

Vice President  
Information Technology

#### Eric Sills

Vice President  
Engine Management Division

#### Thomas S. Tesoro

Vice President  
Human Resources

#### Luc Gregoire

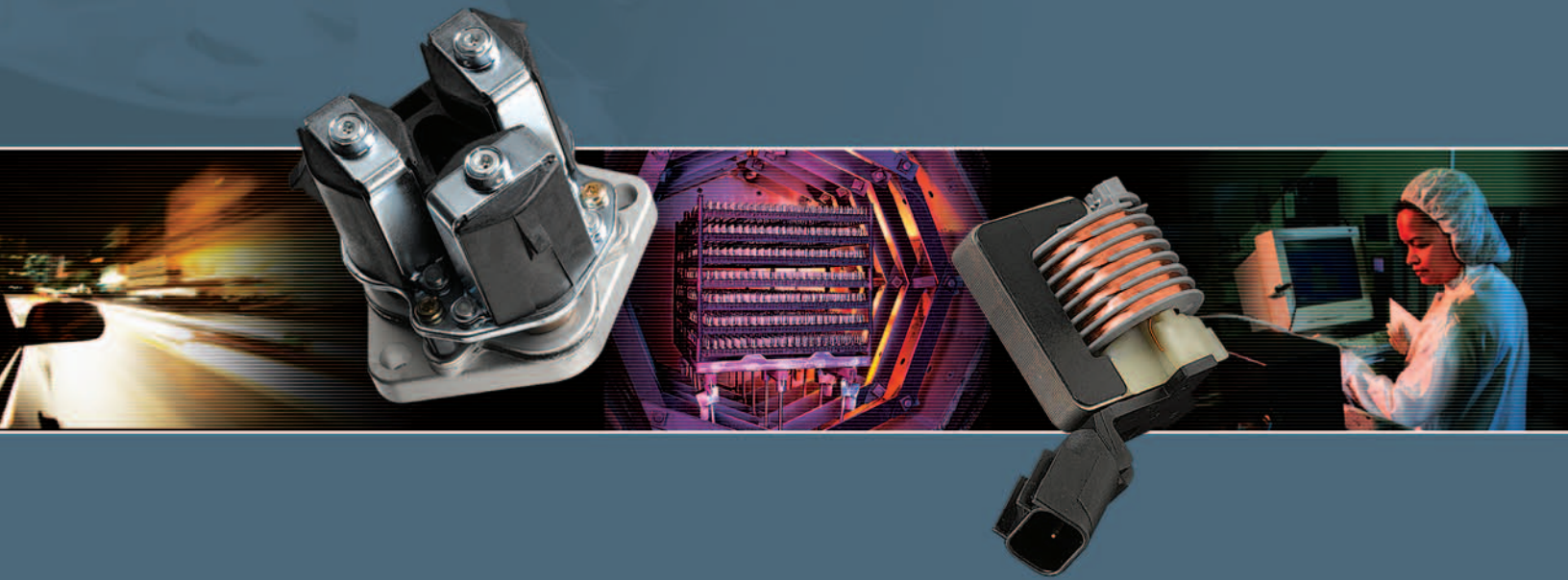
Corporate Controller and  
Chief Accounting Officer

#### Robert H. Martin

Treasurer and Assistant Secretary

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Standard Motor Products, Inc





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