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STANDARD MOTOR PRODUCTS INC  
Form 10-Q  
August 09, 2006

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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006

OR

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

COMMISSION FILE NUMBER: 1-4743

STANDARD MOTOR PRODUCTS, INC.  
(Exact name of registrant as specified in its charter)

NEW YORK  
(State or other jurisdiction of  
incorporation or organization)

11-1362020  
(I.R.S. Employer  
Identification No.)

37-18 NORTHERN BLVD., LONG ISLAND CITY, N.Y. 11101

-----  
(Address of principal executive offices) (Zip Code)

(718) 392-0200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

Yes  No

As of the close of business on July 31, 2006, there were 18,551,557 outstanding shares of the registrant's Common Stock, par value \$2.00 per share.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

INDEX

PART I - FINANCIAL INFORMATION

	PAGE NO.
Item 1. Consolidated Financial Statements:	
Consolidated Balance Sheets as of June 30, 2006 (Unaudited) and December 31, 2005 .....	3
Consolidated Statements of Operations and Retained Earnings (Unaudited) for the Three Months and Six Months Ended June 30, 2006 and 2005 .....	4
Consolidated Statements of Cash Flows (Unaudited) for the Six Months Ended June 30, 2006 and 2005.....	5
Consolidated Statement of Changes in Stockholders' Equity (Unaudited) for the Three Months and Six Months Ended June 30, 2006.....	6
Notes to Consolidated Financial Statements (Unaudited).....	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	20
Item 3. Quantitative and Qualitative Disclosures about Market Risk.....	30
Item 4. Controls and Procedures.....	31

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.....	31
Item 4. Submission of Matters to a Vote of Security Holders.....	32
Item 6. Exhibits.....	33
Signatures.....	33

PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	June 30, 2006
	----- (Unaudited)
ASSETS	
CURRENT ASSETS:	
Cash and cash equivalents.....	\$ 11,164
Accounts receivable, less allowance for discounts and doubtful accounts of \$10,776 and \$9,574 for 2006 and 2005, respectively.....	265,270
Inventories.....	235,091
Deferred income taxes.....	14,208
Prepaid expenses and other current assets.....	9,831
	-----
Total current assets.....	535,564
Property, plant and equipment, net.....	84,121
Goodwill and other intangibles, net.....	56,006
Other assets.....	37,400
	-----
Total assets.....	\$ 713,091 =====
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Notes payable.....	\$ 192,820
Current portion of long-term debt.....	542
Accounts payable.....	60,296
Sundry payables and accrued expenses.....	28,555
Accrued customer returns.....	27,820
Restructuring accrual.....	903
Accrued rebates.....	23,566
Payroll and commissions.....	15,781
	-----
Total current liabilities.....	350,283
	-----
Long-term debt.....	98,265
Post-retirement medical benefits and other accrued liabilities.....	47,273
Restructuring accrual.....	418
Accrued asbestos liabilities.....	24,241
	-----
Total liabilities.....	520,480
	-----
Commitments and contingencies	
Stockholders' equity:	
Common stock - par value \$2.00 per share:	
Authorized - 30,000,000 shares; issued 20,486,036 shares.....	40,972
Capital in excess of par value.....	57,176
Retained earnings.....	113,368
Accumulated other comprehensive income.....	5,609
Treasury stock - at cost 2,180,054 and 2,315,645 shares in 2006 and 2005, respectively).....	(24,514)

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Total stockholders' equity.....	192,611
Total liabilities and stockholders' equity.....	\$ 713,091

See accompanying notes to consolidated financial statements.

-3-

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

	Three Months Ended June 30,		Six Month June
	2006	2005	2006
	(Unaudited)		(Unaudited)
Net sales .....	\$ 229,174	\$ 226,512	\$ 439,250
Cost of sales .....	172,468	177,602	329,313
Gross profit .....	56,706	48,910	109,937
Selling, general and administrative expenses ....	42,995	43,705	86,783
Restructuring expenses .....	143	3,878	230
Operating income .....	13,568	1,327	22,924
Other income, net .....	810	1,194	1,160
Interest expense .....	5,255	4,290	9,708
Earnings (loss) from continuing operations before taxes .....	9,123	(1,769)	14,376
Provision (benefit) for income tax .....	3,668	(488)	6,323
Earnings (loss) from continuing operations	5,455	(1,281)	8,053
Loss from discontinued operation .....	(289)	(384)	(1,053)
Net earnings (loss) .....	5,166	(1,665)	7,000
Retained earnings at beginning of period .....	109,848	119,117	109,649
	115,014	117,452	116,649
Less: cash dividends for period .....	1,646	1,758	3,281
Retained earnings at end of period .....	\$ 113,368	\$ 115,694	\$ 113,368
PER SHARE DATA:			
Net earnings (loss) per common share - Basic:			
Earnings (loss) from continuing operations .	\$ 0.30	\$ (0.07)	\$ 0.44
Discontinued operation .....	(0.02)	(0.02)	(0.06)
Net earnings (loss) per common share - Basic ....	\$ 0.28	\$ (0.09)	\$ 0.38

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	=====	=====	=====
Net earnings (loss) per common share - Diluted:			
Earnings (loss) from continuing operations .	\$ 0.30	\$ (0.07)	\$ 0.44
Discontinued operation .....	(0.02)	(0.02)	(0.06)
	-----	-----	-----
Net earnings (loss) per common share - Diluted ..	\$ 0.28	\$ (0.09)	\$ 0.38
	=====	=====	=====
Average number of common shares .....	18,297,155	19,538,269	18,245,253
	=====	=====	=====
Average number of common shares and dilutive common shares .....	18,327,895	19,538,269	18,260,708
	=====	=====	=====

See accompanying notes to consolidated financial statements

-4-

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

	Six Months Ended June 30,	
	2006	2005
	----	----
	(Unaudited)	
CASH FLOW FROM OPERATING ACTIVITIES:		
Net earnings (loss) .....	\$ 7,000	\$ (1,000)
Adjustments to reconcile net earnings (loss) to net cash used in operating activities:		
Depreciation and amortization .....	8,011	8,800
Increase to allowance for doubtful accounts .....	426	300
Increase to inventory reserves .....	2,532	1,200
Loss on disposal of property, plant and equipment .....	4	2,200
Equity income from joint ventures .....	(449)	(300)
Employee stock ownership plan allocation .....	596	600
Stock-based compensation .....	544	100
Increase in tax valuation allowance .....	--	800
Decrease in deferred income taxes .....	4,749	
Loss from discontinued operation .....	1,053	700
Change in assets and liabilities:		
Increase in accounts receivable .....	(89,402)	(97,700)
Decrease (increase) in inventories .....	5,674	(4,000)
Increase in prepaid expenses and other current assets .....	(1,265)	(700)
Decrease in other assets .....	2,321	1,000
Increase in accounts payable .....	13,919	14,900
Increase (decrease) in sundry payables and accrued expenses .....	3,638	(9,000)
Decrease in restructuring accrual .....	(860)	(4,800)
Increase in other liabilities .....	8,467	8,700
	-----	-----

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Net cash used in operating activities .....	(33,042)	(77,9
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of property, plant and equipment .....	13	1,9
Capital expenditures .....	(5,061)	(4,1
Net cash used in investing activities .....	(5,048)	(2,2
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net borrowings under line-of-credit agreements .....	43,584	69,0
Principal payments and retirement of long-term debt .....	(284)	(2
(Decrease) increase in overdraft balances .....	(6,158)	7,5
Dividends paid .....	(3,281)	(3,5
Net cash provided by financing activities .....	33,861	72,7
Effect of exchange rate changes on cash .....	1,347	(1,3
Net decrease in cash and cash equivalents .....	(2,882)	(8,7
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD .....	14,046	14,9
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD .....	\$ 11,164	\$ 6,1
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest .....	\$ 9,429	\$ 8,0
Income taxes .....	\$ 2,195	\$ 2,3
Non-cash financing activity:		
Reduction of restructuring accrual applied against goodwill .....	\$ 10,453	\$ --

See accompanying notes to consolidated financial statements.

-5-

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

THREE MONTHS ENDED JUNE 30, 2006  
(Unaudited)

	COMMON STOCK -----	CAPITAL IN EXCESS OF PAR VALUE -----	RETAINED EARNINGS -----	ACCUMULATED OTHER COMPREHENSIVE INCOME -----
Balance at March 31, 2006.....	\$ 40,972	\$ 57,107	\$ 109,848	\$ 4,256
Comprehensive income:				

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Net income.....			5,166	
Foreign currency translation adjustment.....				1,525
Unrealized loss on interest rate swap agreements, net of tax.....				(80)
Minimum pension liability adjustment.....				(92)
Total comprehensive income.....				
Cash dividends paid.....			(1,646)	
Employee stock compensation.....	69			
Employee Stock Ownership Plan.....				
Balance at June 30, 2006.....	\$ 40,972	\$ 57,176	\$ 113,368	\$ 5,609

SIX MONTHS ENDED JUNE 30, 2006  
(Unaudited)

	COMMON STOCK	CAPITAL IN EXCESS OF PAR VALUE	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME
Balance at December 31, 2005.....	\$ 40,972	\$ 56,966	\$ 109,649	\$ 4,158
Comprehensive income:				
Net income.....			7,000	
Foreign currency translation adjustment.....				1,688
Unrealized loss on interest rate swap agreements, net of tax.....				(152)
Minimum pension liability adjustment.....				(85)
Total comprehensive income.....				
Cash dividends paid.....			(3,281)	
Employee stock compensation.....		352		
Employee Stock Ownership Plan.....		(142)		
Balance at June 30, 2006.....	\$ 40,972	\$ 57,176	\$ 113,368	\$ 5,609

-6-

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

Standard Motor Products, Inc. (referred to hereinafter in these notes to

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consolidated financial statements as the "Company," "we," "us," or "our") is engaged in the manufacture and distribution of replacement parts for motor vehicles in the automotive aftermarket industry.

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

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

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

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

### NOTE 2. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### SHARE-BASED PAYMENT

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

Prior to the adoption of SFAS No. 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 second quarter of 2006 was \$126,500 (\$87,300 net of tax) or \$0.01 per basic and diluted share and \$409,500 (\$260,300 net of tax) or \$0.01 per basic and diluted share for the six months ended June 30, 2006. The adoption of SFAS123R did not have a material impact on our financial position, results of operation or cash flows.



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

### ACCOUNTING FOR UNCERTAIN TAX POSITIONS

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting involved in the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 prescribes applying a "more likely than not" threshold to the recognition and derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact of FIN 48 on its results of operations and financial position but does not believe it would materially change the way we evaluate tax positions for recognition.

### NOTE 3. 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") on June 30, 2003, we have reviewed our operations and implemented integration plans to restructure the operations of DEM. At the time, we announced that we would close seven DEM facilities, which has subsequently occurred. As part of the integration and restructuring plans, we accrued an initial restructuring liability of approximately \$34.7 million at June 30, 2003. Such amounts were recognized as liabilities assumed in the acquisition and included in the allocation of the cost to acquire DEM. Accordingly, such amounts resulted in additional goodwill being recorded in connection with the acquisition. Subsequent to the acquisition, our estimate of the restructuring liability was updated and revised downward, with corresponding reductions to goodwill, by \$1 million, \$1.2 million, \$10.2 million and \$0.2 million as at December 31, 2003, December 31, 2005, March 31, 2006 and June 30, 2006, respectively. As of June 30, 2006, the restructuring accrual was at \$1.3 million. We expect to pay most of this remaining amount in 2006 and 2007.

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

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

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above reduction, exit costs of \$0.8 million were paid as of June 30, 2006, leaving the exit reserve balance for exit costs at \$0.6 million as of June 30, 2006.

-8-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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

	Workforce Reduction	Other Exit Costs	Total
Restructuring liability at December 31, 2005 .....	\$ 809	\$ 11,825	\$ 12,634
Cash payments during first six months of 2006 ....	(103)	(757)	(860)
Adjustments during first six months of 2006 .....	--	(10,453)	(10,453)
Restructuring liability as of June 30, 2006 .....	\$ 706	\$ 615	\$ 1,321

#### INTEGRATION EXPENSES

During the second quarter of 2006 and 2005, we incurred integration expenses of approximately \$0.1 and \$3.9 million, respectively. For the six months ended June 30, 2006 and 2005, we incurred integration expenses of \$0.2 and \$4.4 million, respectively. The 2006 amount relates to the cost of moving our European production operations. In the second quarter of 2005, the Company effected an asset write-down for the outsourcing of some of its Temperature Control product lines resulting in a \$3.5 million integration expense.

#### NOTE 4. INVENTORIES

	June 30, 2006	December 31, 2005
(in thousands)		
Finished goods, net.....	\$ 170,897	\$ 182,567
Work in process, net.....	4,783	4,235
Raw materials, net.....	59,411	56,495
Total inventories, net.....	\$ 235,091	\$ 243,297

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

Total debt consists of (in thousands):

	June 30, 2006	December 31, 2005

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Revolving credit facilities (1).....	\$ 192,820	\$ 149,236
Current portion of mortgage loan.....	542	542
	-----	-----
	193,362	149,778
	-----	-----
 LONG-TERM DEBT		
6.75% convertible subordinated debentures.....	90,000	90,000
Mortgage loan.....	8,667	8,912
Other.....	140	179
Less current portion of long-term debt.....	542	542
	-----	-----
	98,265	98,549
	-----	-----
 Total debt.....	 \$ 291,627	 \$ 248,327
	=====	=====

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

-9-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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

The Company had deferred financing cost of \$4.5 million and \$3.7 million as of December 31, 2005 and June 30, 2006, respectively. These costs related to the Company's revolving credit facility, the convertible subordinated debentures and a mortgage loan agreement, and these costs are being amortized over three to thirteen years.

#### REVOLVING CREDIT FACILITY

We are parties to an agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The term of the credit agreement is through 2008 and provides for a line of credit up to \$305 million. Availability under our revolving credit facility is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. After taking into effect outstanding borrowings under the revolving credit facility, there was an additional \$70.7 million available for us to borrow pursuant to the formula at June 30, 2006. Our credit agreement also permits dividends and distributions by us provided specific conditions are met.

At December 31, 2005 and June 30, 2006, the interest rate on the Company's revolving credit facility was 6.7% and 7.4%, respectively. Direct borrowings under our revolving credit facility bear interest at the prime rate plus the applicable margin (as defined) or the LIBOR rate plus the applicable margin (as defined), at our option. Outstanding borrowings under the revolving credit facility (inclusive of the Canadian term loan described below), classified as current liabilities, were \$142.3 million and \$184.9 million at December 31, 2005 and June 30, 2006, respectively. The Company maintains cash management systems in compliance with its credit agreements. Such systems require the establishment

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of lock boxes linked to blocked accounts whereby cash receipts are channeled to various banks to insure pay-down of debt. Agreements also classify such accounts and the cash therein as additional security for loans and other obligations to the credit providers. Borrowings are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. The terms of our revolving credit facility provide for, among other provisions, financial covenants requiring us, on a consolidated basis, (1) to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months) through 2008, and (2) to limit capital expenditure levels for each fiscal year through 2008. The terms of our revolving credit facility also provide, among other things, for the prohibition of accepting drafts under our customer draft programs after November 18, 2005.

### CANADIAN TERM LOAN

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

### REVOLVING CREDIT FACILITY--EUROPE

Our European Segment has a revolving credit facility, which provides for a line of credit of up to \$8.2 million. The amount of short-term bank borrowings outstanding under this facility was \$7 million and \$7.9 million at December 31, 2005 and June 30, 2006, respectively. The weighted average interest rates on these borrowings at December 31, 2005 and June 30, 2006 were 6.5% and 6.1%, respectively. At June 30, 2006, there was an additional \$0.3 million available for our European Segment to borrow.

-10-

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

#### SUBORDINATED DEBENTURES

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

#### MORTGAGE LOAN AGREEMENT

In June 2003, we borrowed \$10 million under a mortgage loan agreement. The loan

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is payable in monthly installments. The loan bears interest at a fixed rate of 5.50% maturing in July 2018. The mortgage loan is secured by a building and related property.

### NOTE 6. COMPREHENSIVE INCOME

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net income (loss) as reported .....	\$ 5,166	\$ (1,665)	\$ 7,000	\$ (1,019)
Foreign currency translation adjustment ....	1,525	(1,388)	1,688	(1,781)
Minimum pension liability adjustment .....	(92)	162	(85)	234
Unrealized (loss) gain on interest rate swap agreements, net of tax .....	(80)	(86)	(152)	64
	\$ 6,519	\$ (2,977)	\$ 8,451	\$ (2,502)
	=====	=====	=====	=====

### NOTE 7. STOCK-BASED COMPENSATION PLANS

We have principally five fixed 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 June 30, 2006, under our stock option plans, there were an aggregate of (a) 1,152,486 shares of common stock authorized for grants, (b) 1,108,811 shares of common stock granted, and (c) no shares of common stock available for future grants. At June 30, 2006, under our 2006 Omnibus Incentive Plan, there were an aggregate of (a) 700,000 shares of common stock authorized for grants, (b) 87,325 shares of common stock granted, and (c) 612,675 shares of common stock available for future grants.

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

Effective January 1, 2006, we adopted SFAS No. 123R, "Share-Based Payment," which prescribes the accounting for equity instruments exchanged for employee and director services. Under SFAS No. 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 No. 123R. We have followed the SEC's guidance in SAB No. 107 in our adoption of SFAS No. 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 No. 123, "Accounting for Stock-Based Compensation," as amended, "Accounting for Stock-Based Compensation--Transition and Disclosure".

We adopted SFAS No. 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 No. 123 for all stock-based compensation that was granted prior to, but vested on or after, January 1, 2006; and (b) SFAS No. 123R for all stock-based compensation that was granted on or after January 1, 2006. Stock-based compensation expense for the second quarter of 2006 was \$126,500 (\$87,300 net of tax) or \$0.01 per basic and diluted share and \$409,500 (\$260,300 net of tax) or \$0.01 per basic and diluted share for the six months ended June 30, 2006.

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

	THREE MONTHS ENDED JUNE 30, 2005	SIX MONTHS ENDED JUNE 30, 2005
	-----	-----
Net loss as reported .....	\$ (1,665)	\$ (1,019)
Less: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects .....	(183)	(312)
	-----	-----
Pro forma net loss .....	\$ (1,848)	\$ (1,331)
Loss per share:		
Basic - as reported .....	\$ (0.09)	\$ (0.05)
Basic - pro forma .....	\$ (0.09)	\$ (0.07)
Diluted - as reported .....	\$ (0.09)	\$ (0.05)
Diluted - pro forma .....	\$ (0.09)	\$ (0.07)

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

#### STOCK OPTION GRANTS

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

The stock options granted prior to 2006 have been vesting gradually at annual intervals. In our prior period SFAS No. 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 is computed using the Black Scholes option pricing model with the following assumptions applicable to each remaining unvested annual grant:

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

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

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

	Shares	Weighted Average Exercise Price	Weighted Average Contract Life (year)
	-----	-----	-----
Outstanding at beginning of year.....	1,249,226	\$ 14.42	5.2
Expired.....	132,165	\$ 19.33	0
Forfeited.....	8,250	\$ 12.74	6.4
<hr style="border-top: 1px dashed black;"/>			
Outstanding at end of Quarter.....	1,108,811	\$ 13.84	5.3
<hr style="border-top: 1px dashed black;"/>			

Options exercisable at end

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of quarter..... 977,061            \$ 14.14                            4.8

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The aggregate intrinsic value of the outstanding stock options was \$0.

-13-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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

	SHARES	WEIGHTED AVERAGE GRANT DATE FAIR VALUE
	-----	-----
Non-vested shares at January 1, 2006...	494,426	\$ 3.04
Forfeitures.....	3,000	\$ 3.09
Vested.....	359,676	\$ 3.16
Non-vested shares at June 30, 2006.....	131,750	\$ 2.72

As of June 30, 2006, we have \$268,800 of total unrecognized compensation cost related to non-vested stock options granted under our various option-based plans, which we expect to recognize over a weighted-average period of 0.8 years. No stock options were exercised during the six months ended June 30, 2006.

#### RESTRICTED AND PERFORMANCE STOCK GRANTS

Under our 2006 Omnibus Incentive Plan, the Company is authorized to issue, among other things, shares of restricted and performance based stock to eligible employees and directors. Prior to the time a restricted share becomes fully vested or a performance share is issued, the awardee cannot transfer, pledge, hypothecate or encumber such shares. Prior to the time a restricted share is fully vested, the awardee has all other rights of a stockholder, including the right to vote (but not receive dividends during the vesting period). Prior to the time a performance share is issued, the awardee shall have no rights as a stockholder. Restricted shares become fully vested upon the third and first anniversary of the date of grant for employees and directors, respectively. Performance based shares are subject to a three year measuring period and the achievement of Company performance targets and then become fully vested on the third anniversary of the date of grant. 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 three months ended June 30, 2006, 87,325 restricted and performance based shares were granted (63,575 restricted shares and 23,750 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 expected life at the grant date. The fair value of the shares at the date of grant is amortized to expense ratably over the restriction period. For the quarter ended June 30, 2006, forfeitures are estimated at 2% for employees and 0% executives and directors, respectively, based on evaluations of historical and expected future turnover.



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The Company recorded pre-tax compensation expense related to restricted shares and performance based shares of \$38,200 and \$0 for the six months ended June 30, 2006 and 2005, respectively. The tax benefit recorded related to this compensation expense was \$13,900 and \$0 for the six months ended June 30, 2006 and 2005, respectively. The unamortized compensation expense related to the Company's restricted and performance based shares was \$558,800 at June 30, 2006 and is expected to be recognized over a weighted average period of 2.8 and 0.8 years for employees and directors, respectively.

-14-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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

	Shares	Weighted Average Grant Date Fair Value Per Share
Balance at January 1, 2006 .....	0	\$ 0.00
Granted .....	87,325	\$ 6.95
Vested .....	0	\$ 0.00
Forfeited .....	0	\$ 0.00
Balance at June 30, 2006 .....	87,325	\$ 6.95

The weighted-average grant date fair value of restricted and performance based shares granted during the six months ended June 30, 2006 was \$606,600, or \$6.95 per share. No restricted or performance based shares were authorized, granted, outstanding or vested during the six months ended June 30, 2005.

#### NOTE 8. EARNINGS PER SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	
Earnings (loss) from continuing operations	\$ 5,455	\$ (1,281)	\$ 8,053	\$
Loss from discontinued operations .....	(289)	(384)	(1,053)	
Net earnings (loss) available to				

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common stockholders .....	\$ 5,166	\$ (1,665)	\$ 7,000	\$
	=====	=====	=====	=====
Weighted average common shares outstanding				
- basic .....	18,297,155	19,538,269	18,245,253	19
Dilutive effect of restricted stock .....	30,740	--	15,455	
	-----	-----	-----	-----
Weighted average common shares				
outstanding - diluted .....	18,327,895	19,538,269	18,260,708	19
	=====	=====	=====	=====

The 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	----	----	----	----
Stock options .....	1,108,811	1,330,451	1,108,811	1,330,451
Convertible debentures .....	2,796,120	2,796,120	2,796,120	2,796,120

-15-

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

NOTE 9. EMPLOYEE BENEFITS

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

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

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

We provide certain medical and dental care benefits to eligible retired employees. Our current policy is to fund the cost of the health care plans on a pay-as-you-go basis. Effective September 1, 2005, we restricted the eligibility requirements of employees who can participate in this program, whereby all

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active participants hired after 1995 are no longer eligible. In the three months ended September 30, 2005, in accordance with SFAS No. 106, Employers' Accounting For Post-Retirement Benefits Other Than Pensions, we recognized a curtailment gain of \$3.8 million for our post-retirement plan mainly related to the above changes made to our plan. The curtailment accounting requires us to recognize immediately a pro-rata portion of the unrecognized prior service cost as a result of the changes.

In December 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "Medicare Reform Act") was signed into law. The Medicare Reform Act expanded Medicare to include, for the first time, coverage for prescription drugs. In connection with the Medicare Reform Act, the FASB issued FASB Staff Position ("FSP") No. FAS 106-2, which provides guidance on accounting for the effects of the new Medicare prescription drug legislation for employers whose prescription drug benefits are actuarially equivalent to the drug benefit under Medicare Part D and are therefore entitled to receive subsidies from the federal government beginning in 2006. On January 21, 2005, the Centers for Medicare and Medicaid Services released final regulations implementing major provisions of the Medicare Reform Act. The regulations address key concepts, such as defining a plan, as well as the actuarial equivalence test for purposes of obtaining a government subsidy. Pursuant to the guidance in FSP No. FAS 106-2, we have 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 \$9.3 million. As a result, our 2005 post-retirement benefit cost decreased by approximately \$1.1 million. The impact of the Medicare Reform Act on our post-retirement plan was compounded by changes made during the year in the modalities of the plan, namely regarding increased participant contributions and reduced eligibility.

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.

-16-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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

	-----			
	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
Service cost .....	\$ 99	\$ 130	\$ 202	\$ 726
Interest cost .....	100	131	478	530

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Amortization of prior service cost .....	28	40	(712)	31
Actuarial net loss .....	(16)	5	305	--
Amortization of unrecognized loss .....	--	--	4	1
	-----	-----	-----	-----
Net periodic benefit cost .....	\$ 211	\$ 306	\$ 277	\$1,288
	=====	=====	=====	=====

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

	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
Service cost .....	\$ 198	\$ 260	\$ 404	\$ 1,636
Interest cost .....	200	262	955	1,079
Amortization of prior service cost ...	56	80	(1,425)	62
Actuarial net loss .....	(32)	10	611	--
Amortization of unrecognized loss ....	--	--	8	2
	-----	-----	-----	-----
Net periodic benefit cost .....	\$ 422	\$ 612	\$ 553	\$ 2,779
	=====	=====	=====	=====

NOTE 10. INDUSTRY SEGMENTS

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

	Three Months Ended June 30,			
	2006		2005	
	NET SALES	OPERATING INCOME (LOSS)	NET SALES	OPERATING INCOME (LOSS)
	-----	-----	-----	-----
Engine Management .....	\$139,825	\$ 11,296	\$143,595	\$ 7,049
Temperature Control .....	72,304	6,165	67,440	(58)
Europe .....	13,542	352	12,134	17
All Other .....	3,503	(4,245)	3,343	(5,681)
	-----	-----	-----	-----
Consolidated .....	\$229,174	\$ 13,568	\$226,512	\$ 1,327
	=====	=====	=====	=====

	Six Months Ended June 30,			
	2006		2005	
	NET SALES	OPERATING INCOME (LOSS)	NET SALES	OPERATING INCOME (LOSS)
	-----	-----	-----	-----

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Engine Management .....	\$288,710	\$ 23,492	\$284,036	\$ 17,129
Temperature Control .....	121,372	7,599	121,002	1,499
Europe .....	23,378	392	23,079	(462)
All Other .....	5,790	(8,559)	5,721	(11,004)
	-----	-----	-----	-----
Consolidated .....	\$439,250	\$ 22,924	\$433,838	\$ 7,162
	=====	=====	=====	=====

-17-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

#### NOTE 11. COMMITMENTS AND CONTINGENCIES

ASBESTOS. In 1986, we acquired a brake business, which we subsequently sold in March 1998 and which is accounted for as a discontinued operation. When we originally acquired this brake business, we assumed future liabilities relating to any alleged exposure to asbestos-containing products manufactured by the seller of the acquired brake business. In accordance with the related purchase agreement, we agreed to assume the liabilities for all new claims filed on or after September 1, 2001. Our ultimate exposure will depend upon the number of claims filed against us on or after September 1, 2001 and the amounts paid for indemnity and defense thereof. At December 31, 2005 and June 30, 2006, approximately 4,500 cases and 3,200 cases, respectively, were outstanding for which we were responsible for any related liabilities. In the first six months of 2006, we settled a significant number of cases. 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 June 30, 2006, the amounts paid for settled claims are approximately \$4.2 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. Actuarial consultants with experience in assessing asbestos-related liabilities completed a study in September 2002 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 for the remainder of 2002 through 2052; (3) an analysis of our currently pending claims; and (4) an analysis of our settlements to date in order to develop average settlement values. 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 \$27.3 million to \$58 million for the period through 2052. Accordingly, based on the information contained in the actuarial study and all other available information considered by us, we recorded an after tax charge of \$16.9 million as a loss from discontinued operation during the third quarter of 2002 to reflect such liability, excluding legal costs, thereby increasing our liability to \$27.3 million as of September 30, 2002. We concluded that no amount within the range

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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 2052 in our consolidated financial statements, in accordance with generally accepted accounting principles.

As is our accounting policy, we update the actuarial study during the third quarter of each year. The most recent update to the actuarial study was performed as of August 31, 2005 using methodologies consistent with the September 2002 study. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$25 to \$51 million for the period through 2049. Although there was a decline in the range of liability as compared to the prior year study, given the relative volatility of the actuarial evaluations over the prior three years, we decided to maintain a reserve of \$27.6 million until more experience is gained. Legal costs, which are expensed as incurred, are estimated to range from \$16 to \$20 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.

-18-

### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

**ANTITRUST LITIGATION.** On November 30, 2004, we were served with a summons and complaint in the U.S. District Court for the Southern District of New York by The Coalition For A Level Playing Field, which is an organization comprised of a large number of auto parts retailers. The complaint alleges antitrust violations by the Company and a number of other auto parts manufacturers and retailers and seeks injunctive relief and unspecified monetary damages. In August 2005, we filed a motion to dismiss the complaint, following which the plaintiff filed an amended complaint dropping, among other things, all claims under the Sherman Act. The remaining claims allege violations of the Robinson-Patman Act. Motions to dismiss those claims were filed by us in February 2006. Plaintiff has filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments have been scheduled for September 2006, after which we expect a decision by the court regarding these motions. 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

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of the relevant facts and circumstances, it is our opinion that the final outcome of these matters will not have a material adverse effect on our business, financial condition or results of operations.

WARRANTIES. We generally warrant our products against certain manufacturing and other defects. These product warranties are provided for specific periods of time of the product depending on the nature of the product. As of June 30, 2006 and 2005, we have accrued \$15.4 million and \$15.9 million, respectively, for estimated product warranty claims included in accrued customer returns. The accrued product warranty costs are based primarily on historical experience of actual warranty claims. Warranty expense for the three months ended June 30, 2006 and 2005 were \$14.4 million and \$16 million, respectively, and \$27.5 million and \$27.2 million for the six months ended June 30, 2006 and 2005, respectively.

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

	Three Months Ended June 30,		Six Months Ended June 30
	2006	2005	2006
	----	----	----
Balance, beginning of period.....	\$ 13,050	\$ 12,982	\$ 12,701
Liabilities accrued for current year sales.....	14,394	16,042	27,537
Settlements of warranty claims.....	(12,053)	(13,126)	(24,847)
	-----	-----	-----
Balance, end of period.....	\$ 15,391	\$ 15,898	\$ 15,391
	=====	=====	=====

-19-

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

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

FORWARD-LOOKING STATEMENTS IN THIS REPORT ARE INDICATED BY WORDS SUCH AS "ANTICIPATES," "EXPECTS," "BELIEVES," "INTENDS," "PLANS," "ESTIMATES," "PROJECTS" AND SIMILAR EXPRESSIONS. THESE STATEMENTS REPRESENT OUR EXPECTATIONS BASED ON CURRENT INFORMATION AND ASSUMPTIONS AND ARE INHERENTLY SUBJECT TO RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE WHICH ARE ANTICIPATED OR PROJECTED AS A RESULT OF CERTAIN RISKS AND UNCERTAINTIES, INCLUDING, BUT NOT LIMITED TO, ECONOMIC AND MARKET CONDITIONS; THE PERFORMANCE OF THE AFTERMARKET SECTOR; CHANGES IN BUSINESS RELATIONSHIPS WITH OUR MAJOR CUSTOMERS AND IN THE TIMING, SIZE AND CONTINUATION OF OUR CUSTOMERS' PROGRAMS; CHANGES IN THE PRODUCT MIX AND DISTRIBUTION CHANNEL MIX; THE ABILITY OF OUR CUSTOMERS TO ACHIEVE THEIR PROJECTED SALES; COMPETITIVE PRODUCT AND PRICING PRESSURES; INCREASES IN PRODUCTION OR MATERIAL COSTS THAT CANNOT BE RECOUPED IN

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PRODUCT PRICING; SUCCESSFUL INTEGRATION OF ACQUIRED BUSINESSES; PRODUCT AND ENVIRONMENTAL LIABILITY MATTERS (INCLUDING, WITHOUT LIMITATION, THOSE RELATED TO ASBESTOS-RELATED CONTINGENT LIABILITIES OR ENVIRONMENTAL REMEDIATION LIABILITIES); AS WELL AS OTHER RISKS AND UNCERTAINTIES, SUCH AS THOSE DESCRIBED UNDER RISK FACTORS, QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK AND THOSE DETAILED HEREIN AND FROM TIME TO TIME IN THE FILINGS OF THE COMPANY WITH THE SEC. FORWARD-LOOKING STATEMENTS ARE MADE ONLY AS OF THE DATE HEREOF, AND THE COMPANY UNDERTAKES NO OBLIGATION TO UPDATE OR REVISE THE FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE. IN ADDITION, HISTORICAL INFORMATION SHOULD NOT BE CONSIDERED AS AN INDICATOR OF FUTURE PERFORMANCE. THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS, INCLUDING THE NOTES THERETO, INCLUDED ELSEWHERE IN THIS REPORT.

### BUSINESS OVERVIEW

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

As part of our efforts to grow our business, as well as to achieve increased production and distribution efficiencies, on June 30, 2003 we completed the acquisition of substantially all of the assets and assumed substantially all of the operating liabilities of Dana Corporation's Engine Management Group ("DEM"). Under the terms of the acquisition, we paid Dana Corporation \$93.2 million in cash, issued an unsecured promissory note of \$15.1 million, and issued 1,378,760 shares of our common stock valued at \$15.1 million. Including transaction costs, our total purchase price was approximately \$130.5 million. On December 29, 2005, we entered into a Repurchase and Prepayment Agreement with Dana, in which we repurchased the 1,378,760 shares of our common stock at a repurchase price of \$8.63 per share (or an aggregate approximate repurchase price of \$11.9 million) and prepaid at a discount the \$15.1 million unsecured promissory note plus accrued and unpaid interest for an aggregate approximate amount of \$14.5 million. We recognized the discount of \$1.0 million as a gain on the repayment of the note as well as the unrecognized deferred interest expense thereon of \$0.2 million as income in 2005.

In connection with our acquisition of DEM, we reviewed our operations and implemented integration plans to restructure the operations of DEM. As part of the integration and restructuring plans, we accrued an initial restructuring liability of approximately \$34.7 million at June 30, 2003. Such amounts were recognized as liabilities assumed in the acquisition and included in the allocation of the cost to acquire DEM. Accordingly, such amounts resulted in additional goodwill being recorded in connection with the acquisition. Subsequent to the acquisition, our estimate of the restructuring liability was updated and revised downward, with corresponding reductions to goodwill, by \$1 million, \$1.2 million, \$10.2 million and \$0.2 million as at December 31, 2003, December 31, 2005, March 31, 2006 and June 30, 2006, respectively. As of June 30, 2006, the restructuring accrual was \$1.3 million. We expect to pay most of this remaining amount in 2006 and 2007.



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

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

SEASONALITY. Historically, our operating results have fluctuated by quarter, with the greatest sales occurring in the second and third quarters of the year and revenues generally being recognized at the time of shipment. It is in these quarters that demand for our products is typically the highest, specifically in the Temperature Control Segment of our business. In addition to this seasonality, the demand for our Temperature Control products during the second and third quarters of the year may vary significantly with the summer weather and customer inventories. For example, a cool summer may lessen the demand for our Temperature Control products, while a hot summer may increase such demand. As a result of this seasonality and variability in demand of our Temperature Control products, our working capital requirements peak near the end of the second quarter, as the inventory build-up of air conditioning products is converted to sales and payments on the receivables associated with such sales have yet to be received. During this period, our working capital requirements are typically funded by borrowing from our revolving credit facility.

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

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

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

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

#### INTERIM RESULTS OF OPERATIONS

##### COMPARISON OF THREE MONTHS ENDED JUNE 30, 2006 TO THE THREE MONTHS ENDED JUNE 30, 2005

SALES. Consolidated net sales for the three months ended June 30, 2006 were \$229.2 million, an increase of \$2.7 million or 1.2%, compared to \$226.5 million in the second quarter of 2005, driven by an increase in sales in our Temperature Control and European Segments of \$4.9 million and \$1.5 million, respectively, partially offset by a sales decrease of \$3.8 million in our Engine Management Segment. The increase in our Temperature Control Segment was primarily due to a shift of sales from the first to second quarter of 2006 arising from the scale-back of its pre-season promotional program in the first quarter of 2006. Our European Segment experienced higher sales in its engine management product line. Our Engine Management Segment experienced a 2.6% decrease for the second quarter of 2006, which partially offset its 6% increase in sales for the first quarter of 2006, resulting in an increase of 1.6% for the six months ended June 30, 2006.

GROSS MARGINS. Gross margins, as a percentage of net sales, increased to 24.7% in the second quarter of 2006 compared to 21.6% in the second quarter of 2005 with corresponding improvements in our Engine Management and Temperature Control Segments. The margin increase in our Engine Management Segment was primarily due to price increases implemented near the end of 2005 and in the first quarter of 2006, as well as reduced product costs. The improvement in our Temperature Control Segment was mainly due to product cost reductions.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative (SG&A) expenses decreased by \$0.7 million to \$43 million in the second quarter of 2006 compared to \$43.7 million in the second quarter of 2005. The decrease in SG&A expenses was primarily attributable to a reduction of \$0.7 million in draft expenses as we terminated our accounts receivable draft program

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in the fourth quarter of 2005. As a percentage of net sales, SG&A expenses for the second quarter of 2006 decreased to 18.8% from 19.3% for the same period in 2005.

RESTRUCTURING EXPENSES. Restructuring expenses, which include restructuring and integration expenses, decreased \$3.7 million in the second quarter of 2006 compared to the second quarter of 2005. Integration expenses of \$0.1 million in 2006 related to the move of our European production operations, while \$3.9 million was incurred in the second quarter of 2005 primarily due to a) a non-cash asset impairment charge of \$3.5 million in our Temperature Control business related to a strategic decision to outsource products previously manufactured, as well as b) \$0.3 million related to the DEM integration which has since been substantially completed.

-22-

OPERATING INCOME. Operating income was \$13.6 million in the second quarter of 2006 compared to \$1.3 million in the second quarter of 2005. The \$12.3 million increase was primarily due to higher gross margins on increased sales, product cost reductions in most segments, lower restructuring expenses and decreased SG&A.

OTHER INCOME, NET. Other income, net was \$0.8 million for the second quarter of 2006 compared to \$1.2 million for the same period in 2005.

INTEREST EXPENSE. Interest expense increased by \$1 million in the second quarter of 2006 compared to the same period in 2005 due to higher average borrowings and higher interest rates during the period. The increase in average borrowings is due to higher accounts receivable levels as a result of the termination of our accounts receivable draft program in the fourth quarter of 2005 (which generated a \$0.7 million reduction in draft expenses as mentioned in the SG&A discussion above) and due to the December 2005 buy-back of 1,378,760 shares of our common stock from Dana Corporation at a repurchase price of \$8.63 per share (or an aggregate approximate repurchase price of \$11.9 million).

INCOME TAX PROVISION. The income tax provision was \$3.7 million in the second quarter of 2006 compared to a benefit of \$0.5 million for the same period in 2005. The increase was primarily due to higher pre-tax earnings and a higher effective rate for the second quarter of 2006. Our effective tax rate for continuing operations was approximately 40.2% in the second quarter of 2006 compared to 27.6% in the second quarter of 2005. The increase in the effective tax rate is primarily due to higher U.S. pre-tax earnings coupled with the expiration of Section 936 of the Internal Revenue Code with regard to our Puerto Rican operations, as well as a \$0.8 million increase to the valuation allowance that lowered the effective benefit rate in the second quarter of 2005.

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

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assumptions. We continue to monitor our trends and weigh these against our recent domestic loss carry forward history. At this time, we have concluded that our current level of valuation allowance of \$26.1 million continues to be appropriate.

LOSS FROM DISCONTINUED OPERATION. Losses from discontinued operation include legal expenses associated with our asbestos-related liability. We recorded \$0.3 million and \$0.4 million as a loss from discontinued operation in the second quarters of 2006 and 2005, respectively. As discussed more fully in note 11 of our notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos-containing products.

COMPARISON OF SIX MONTHS ENDED JUNE 30, 2006 TO THE SIX MONTHS ENDED JUNE 30, 2005

SALES. Consolidated net sales for the six months ended June 30, 2006 were \$439.3 million, an increase of \$5.5 million or 1.2%, compared to \$433.8 million in the same period of 2005, driven by an increase in sales in our Engine Management, Temperature Control and European Segments of \$4.7 million, \$0.4 million and \$0.3 million, respectively. The increase in sales in our Engine Management Segment benefited mostly from price increases.

-23-

GROSS MARGINS. Gross margins, as a percentage of net sales, increased by 2.6 percentage points to 25% for the six months ended June 30, 2006 compared to 22.4% in the same period of 2005, with corresponding improvements in our Engine Management, Temperature Control and European Segments. The margin increase in our Engine Management Segment was primarily due to price increases implemented near the end of 2005 and in the first quarter of 2006, as well as reduced product costs. The improvement in our Temperature Control Segment was mainly due to product cost reductions.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative (SG&A) expenses increased \$1 million to \$86.8 million for the six months ended June 30, 2006 compared to \$85.8 million in the same period of 2005. The increase in SG&A expenses was driven mainly by a marketing expense increase of \$2.5 million, partially offset by a reduction of \$1.4 million in draft expenses as we terminated our accounts receivable draft program in the fourth quarter of 2005. As a percentage of net sales, SG&A expenses for the six months ended June 30, 2006 and 2005 were 19.8% in each period.

RESTRUCTURING EXPENSES. Restructuring expenses, which include restructuring and integration expenses, decreased \$4.2 million for the six months ended June 30, 2006 compared to the same period in 2005. Integration expenses of \$0.2 million in 2006 related to the move of our European production operations, while \$4.4 million was incurred during the same period in 2005 primarily due to a) a non-cash asset impairment charge of \$3.5 million in our Temperature Control business related to a strategic decision to outsource products previously manufactured, as well as b) \$0.7 million related to the DEM integration which has since been substantially completed.

OPERATING INCOME. Operating income was \$22.9 million for the six months ended June 30, 2006 compared to \$7.2 million in the same period in 2005. The \$15.7 million increase was primarily due to higher gross margins from higher Engine Management sales, product cost reductions in our Engine Management, Temperature Control and European Segments, and lower restructuring costs, partially offset by higher SG&A expenses.

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OTHER INCOME, NET. Other income, net increased slightly to \$1.2 million in the six months ended June 30, 2006 compared to \$1 million in the same period in 2005.

INTEREST EXPENSE. Interest expense increased by \$1.6 million for the six months ended June 30, 2006 compared to the same period in 2005 due to higher average borrowings and higher interest rates during the period. The increase in average borrowings is due to higher accounts receivable levels as a result of the termination of our accounts receivable draft program in the fourth quarter of 2005 (which generated a \$1.4 million reduction in draft expenses as mentioned in the SG&A discussion above) and due to the December 2005 buy-back of 1,378,760 shares of our common stock from Dana Corporation at a repurchase price of \$8.63 per share (or an aggregate approximate repurchase price of \$11.9 million).

INCOME TAX PROVISION. The income tax provision was \$6.3 million for the six months ended June 30, 2006 compared to \$0.3 million for the same period in 2005. The increase was primarily due to higher pre-tax earnings.

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

-24-

LOSS FROM DISCONTINUED OPERATION. Losses from discontinued operation reflect legal expenses associated with our asbestos-related liability. We recorded \$1.1 million and \$0.8 million as a loss from discontinued operations for the six months ended June 30, 2006 and 2005, respectively. The increase is primarily due to one-time tax costs associated with the liquidation of the residual assets of the pension plan of the discontinued operation segment. As discussed in note 11 of the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos-containing products.

### LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES. During the first six months of 2006, cash used in operations amounted to \$33 million, compared to \$78 million in the same period of 2005. The decrease in cash used in operations is primarily attributable to higher net earnings, a smaller increase in accounts receivable and decreased inventory levels. The lower increase in accounts receivable was caused by higher December 2005 levels than in December 2004 following the termination of our accounts receivable draft program.

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INVESTING ACTIVITIES. Cash used in investing activities was \$5 million in the first six months of 2006 compared to \$2.2 million in the same period of 2005. The increase was due to higher capital expenditures in 2006, partially offset by the proceeds from the disposal of a former Dana facility in 2005.

FINANCING ACTIVITIES. Cash provided by financing activities was \$33.9 million in the first six months of 2006 compared to \$72.8 million in the same period of 2005. The decrease is primarily due to a lower increase in borrowings under our line of credit and a decrease in our bank overdraft balances due to a lower level of cash used in operating activities.

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 effect outstanding borrowings under the revolving credit facility, there was an additional \$70.7 million available for us to borrow pursuant to the formula at June 30, 2006. Our credit agreement also permits dividends and distributions by us provided specific conditions are met.

Direct borrowings under our revolving credit facility bear interest at the prime rate plus the applicable margin (as defined in the credit agreement) or the LIBOR rate plus the applicable margin (as defined in the credit agreement), at our option. 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.

-25-

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

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approximate amount of \$14.5 million.

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

Our profitability and working capital requirements are seasonal due to the sales mix of temperature control products. Our working capital requirements usually peak near the end of the second quarter, as the inventory build-up of air conditioning products is converted to sales and payments on the receivables associated with such sales begin to be received. These increased working capital requirements are funded by borrowings from our lines of credit. In 2004 and the first quarter of 2005, we also received the benefit from accelerating accounts receivable collections from customer draft programs. However, in the second quarter of 2005 we reduced the early monetizing of these accounts receivable under the draft program. An amendment to our revolving credit facility in November 2005 prohibits us from accepting drafts under our customer draft programs 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 is to mature in October 2006. Under this agreement, we receive a floating rate based on the LIBOR interest rate, and pay a fixed rate of 2.45% on the notional amount of \$25 million.

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

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

-26-

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

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(IN THOUSANDS)	2006	2007	2008	2009	2010	2011
Principal payments of long term debt .....	\$ 542	\$ 555	\$ 512	\$ 90,530	\$ 560	\$
Operating leases .....	6,941	5,839	4,650	3,240	1,175	
Interest rate swap agreements.....	(496)	--	--	--	--	
Post-employee retirement benefits .....	970	1,069	1,536	1,655	1,768	1
Severance payments related to integration .....	396	413	--	--	--	
Total commitments .	\$ 8,353	\$ 7,876	\$ 6,698	\$ 95,425	\$ 3,503	\$ 2

CRITICAL ACCOUNTING POLICIES

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations," where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see note 1 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005. You should be aware that preparation of our consolidated quarterly financial statements in this Report requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our consolidated financial statements, and the reported amounts of revenue and expenses during the reporting periods. We can give no assurance that actual results will not differ from those estimates.

REVENUE RECOGNITION. We derive our revenue primarily from sales of replacement parts for motor vehicles from both our Engine Management and Temperature Control Segments. We recognize revenues when products are shipped and title has been transferred to a customer, the sales price is fixed and determinable, and collection is reasonably assured. For some of our sales of remanufactured products, we also charge our customers a deposit for the return of a used core component which we can use in our future remanufacturing activities. Such deposit is not recognized as revenue but rather carried as a core liability. The liability is extinguished when a core is 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 generally determined on the first-in, first-out basis. Where appropriate, standard cost systems are utilized for purposes of determining cost; the standards are adjusted as necessary to ensure they approximate actual costs. Estimates of lower of cost or market value of inventory are determined at the reporting unit level and are based upon the inventory at that location taken as a whole. These estimates are based upon current economic conditions, historical sales quantities and patterns and, in some cases, the specific risk of loss on



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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 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 at the time it is eventually received from the customer.

-27-

### 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 June 30, 2006, the allowance for sales returns was \$27.8 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 June 30, 2006, the allowance for doubtful accounts and for discounts was \$10.8 million.

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

ACCOUNTING FOR INCOME TAXES. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure 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 recovery is not likely, 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

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

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

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.

-28-

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

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ASBESTOS RESERVE. We are responsible for certain future liabilities relating to alleged exposure to asbestos-containing products. A September 2002 actuarial study estimated a liability for settlement payments ranging from \$27.3 million to \$58 million. 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 2052 in our consolidated financial statements, in accordance with generally accepted accounting principles.

In accordance with our accounting policy, we update the actuarial study during the third quarter of each year. The most recent update to the actuarial study was performed as of August 31, 2005 using methodologies consistent with the September 2002 study. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$25 to \$51 million for the period through 2049. Although there was a decline in the range of liability as compared to the prior year study, given the relative volatility of the actuarial evaluations over the prior three years, we decided to maintain the reserve of \$27.6 million until more experience is gained. Legal costs are estimated to range from \$16 to \$20 million during the same period. We plan on performing a similar actuarial analysis during the third quarter of each year for the foreseeable future. Based on this analysis and all other available information, we will 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. Legal expenses associated with asbestos-related matters are expensed as incurred and recorded as a loss from discontinued operation in the statement of operations.

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.

-29-

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### SHARE-BASED PAYMENT

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

Prior to the adoption of SFAS No. 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

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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 second quarter of 2006 was \$126,500 (\$87,300 net of tax) or \$0.01 per basic and diluted share and \$409,500 (\$260,300 net of tax) or \$0.01 per basic and diluted share for the six months ended June 30, 2006. The adoption of SFAS123R 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" ("FIN 48"). FIN 48 clarifies the accounting involved in the recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 prescribes applying a "more likely than not" threshold to the recognition and derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact of FIN 48 on its results of operations and financial position but does not believe it would materially change the way we evaluate tax positions for recognition.

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

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

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

-30-

We manage our exposure to interest rate risk through the proportion of fixed rate debt and variable rate debt in our debt portfolio. To manage a portion of our exposure to interest rate changes, we enter into interest rate swap agreements. We invest our excess cash in highly liquid short-term investments. Our percentage of variable rate debt to total debt was 60% at December 31, 2005 and 66% at June 30, 2006.

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

### ITEM 4. CONTROLS AND PROCEDURES

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### (a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES.

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

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

### (b) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING.

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

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

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In 1986, we acquired a brake business, which we subsequently sold in March 1998 and which is accounted for as a discontinued operation. When we originally acquired this brake business, we assumed future liabilities relating to any alleged exposure to asbestos-containing products manufactured by the seller of the acquired brake business. In accordance with the related purchase agreement, we agreed to assume the liabilities for all new claims filed on or after September 1, 2001. Our ultimate exposure will depend upon the number of claims filed against us on or after September 1, 2001 and the amounts paid for indemnity and defense thereof. At December 31, 2005 and June 30, 2006 approximately 4,500 cases and 3,200 cases, respectively, were outstanding for which we were responsible for any related liabilities. In the first six months of 2006, we settled a significant number of cases. 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 June 30, 2006, the amounts paid for settled claims are approximately \$4.2 million. We do not have insurance coverage for the defense and indemnity costs associated with these claims.

On November 30, 2004, we were served with a summons and complaint in the U.S. District Court for the Southern District of New York by The Coalition For A

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Level Playing Field, which is an organization comprised of a large number of auto parts retailers. The complaint alleges antitrust violations by the Company and a number of other auto parts manufacturers and retailers and seeks injunctive relief and unspecified monetary damages. In August 2005, we filed a motion to dismiss the complaint, following which the plaintiff filed an amended complaint dropping, among other things, all claims under the Sherman Act. The remaining claims allege violations of the Robinson-Patman Act. Motions to dismiss those claims were filed by us in February 2006. Plaintiff has filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments have been scheduled for September 2006, after which we expect a decision by the court regarding these motions. 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

(a) Our 2006 Annual Meeting of Stockholders was held on May 18, 2006.

(b) The following persons were elected as our directors:

Robert M. Gerrity  
Kenneth A. Lehman  
Lawrence I. Sills  
Arthur S. Sills  
Peter J. Sills  
Frederick D. Sturdivant  
William H. Turner  
Richard S. Ward  
Roger M. Widmann

(c) The following matters were voted upon at the Annual Meeting:

(1) Election of Directors:	VOTES FOR	VOTES WITHHELD
Robert M. Gerrity	12,123,937	2,424,231
Kenneth A. Lehman	12,288,868	2,259,300
Arthur S. Sills	12,196,574	2,351,594
Lawrence I. Sills	12,201,576	2,346,592
Peter J. Sills	12,206,192	2,341,976
Frederick D. Sturdivant	12,123,357	2,424,811
William H. Turner	12,075,637	2,472,531
Richard S. Ward	12,123,375	2,424,793
Roger M. Widmann	12,125,995	2,422,173

(2) Approval of the Standard Motor Products, Inc. 2006 Omnibus

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Incentive Plan:

VOTES FOR	VOTES AGAINST	NON-VOTING	VOTES ABSTAINED
9,212,373	1,462,607	3,826,402	46,786

(3) Ratification of Appointment of Grant Thornton LLP as the Company's Registered Public Accounting Firm:

VOTES FOR	VOTES AGAINST	VOTES ABSTAINED
14,452,119	58,900	37,149

ITEM 6. EXHIBITS

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

SIGNATURES

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

STANDARD MOTOR PRODUCTS, INC.  
(Registrant)

Date: August 9, 2006

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

/S/ LUC GREGOIRE  
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Luc Gregoire  
Corporate Controller and  
Chief Accounting Officer

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STANDARD MOTOR PRODUCTS, INC.

EXHIBIT INDEX

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