

STANDARD MOTOR PRODUCTS INC  
Form 10-Q  
October 30, 2018

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes      No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes      No

As of the close of business on October 26, 2018, there were 22,431,618 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

	<u>Page No.</u>
Item 1. <u>Consolidated Financial Statements:</u>	
<u>Consolidated Statements of Operations (Unaudited) for the Three Months and Nine Months Ended September 30, 2018 and 2017</u>	3
<u>Consolidated Statements of Comprehensive Income (Unaudited) for the Three Months and Nine Months Ended September 30, 2018 and 2017</u>	4
<u>Consolidated Balance Sheets as of September 30, 2018 (Unaudited) and December 31, 2017</u>	5
<u>Consolidated Statements of Cash Flows (Unaudited) for the Nine Months Ended September 30, 2018 and 2017</u>	6
<u>Consolidated Statement of Changes in Stockholders' Equity (Unaudited) for the Nine Months Ended September 30, 2018</u>	7
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	43
Item 4. <u>Controls and Procedures</u>	44

PART II – OTHER INFORMATION

Item 1. <u>Legal Proceedings</u>	45
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
Item 6. <u>Exhibits</u>	46
<u>Signatures</u>	47

Index

## PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018 (Unaudited)	2017	2018 (Unaudited)	2017
Net sales	\$296,619	\$281,058	\$845,081	\$876,165
Cost of sales	209,313	198,523	603,897	618,854
Gross profit	87,306	82,535	241,184	257,311
Selling, general and administrative expenses	60,137	54,963	175,604	172,726
Restructuring and integration expenses	6	1,132	3,073	3,914
Other income, net	15	316	328	946
Operating income	27,178	26,756	62,835	81,617
Other non-operating income, net	351	482	800	2,372
Interest expense	1,254	595	3,137	1,785
Earnings from continuing operations before taxes	26,275	26,643	60,498	82,204
Provision for income taxes	7,002	9,535	15,801	30,468
Earnings from continuing operations	19,273	17,108	44,697	51,736
Loss from discontinued operations, net of income taxes	(3,524)	) (3,983)	) (5,014)	) (5,113)
Net earnings	\$15,749	\$13,125	\$39,683	\$46,623
<u>Per Share Data:</u>				
Net earnings per common share – Basic:				
Earnings from continuing operations	\$0.86	\$0.75	\$1.99	\$2.27
Discontinued operations	(0.16)	) (0.17)	) (0.22)	) (0.22)
Net earnings per common share – Basic	\$0.70	\$0.58	\$1.77	\$2.05
Net earnings per common share – Diluted:				
Earnings from continuing operations	\$0.84	\$0.74	\$1.95	\$2.22
Discontinued operations	(0.15)	) (0.17)	) (0.22)	) (0.22)
Net earnings per common share – Diluted	\$0.69	\$0.57	\$1.73	\$2.00
Dividend declared per share	\$0.21	\$0.19	\$0.63	\$0.57
Average number of common shares	22,424,962	22,660,157	22,464,697	22,774,927
Average number of common shares and dilutive common shares	22,938,925	23,174,700	22,954,649	23,287,052

See accompanying notes to consolidated financial statements (unaudited).

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2018 (Unaudited)	2017	September 30, 2018 (Unaudited)	2017
Net earnings	\$ 15,749	\$ 13,125	\$ 39,683	\$ 46,623
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	719	1,595	(2,997 )	7,051
Pension and postretirement plans:				
Amortization of:				
Unrecognized gain	(10 )	(165 )	(31 )	(496 )
Unrecognized actuarial gains	—	—	12	472
Income tax related to pension and postretirement plans	4	66	8	10
Pension and postretirement plans, net of tax	(6 )	(99 )	(11 )	(14 )
Total other comprehensive income (loss), net of tax	713	1,496	(3,008 )	7,037
Comprehensive income	\$ 16,462	\$ 14,621	\$ 36,675	\$ 53,660

See accompanying notes to consolidated financial statements (unaudited).

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

	September 30, 2018 (Unaudited)	December 31, 2017
(In thousands, except share and per share data)		
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 27,321	\$ 17,323
Accounts receivable, less allowances for discounts and doubtful accounts of \$5,537 and \$4,967 for 2018 and 2017, respectively	163,309	140,057
Inventories	318,420	326,411
Unreturned customer inventories	21,295	—
Prepaid expenses and other current assets	11,681	12,300
Total current assets	542,026	496,091
Property, plant and equipment, net of accumulated depreciation of \$190,015 and \$191,081 for 2018 and 2017, respectively	91,735	89,103
Goodwill	67,387	67,413
Other intangibles, net	50,263	56,261
Deferred income taxes	34,907	32,420
Investments in unconsolidated affiliates	33,785	31,184
Other assets	16,284	15,095
Total assets	\$ 836,387	\$ 787,567
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable	\$ 45,000	\$ 57,000
Current portion of other debt	5,980	4,699
Accounts payable	84,031	77,990
Sundry payables and accrued expenses	30,879	40,012
Accrued customer returns	53,717	35,916
Accrued core liability	30,002	11,899
Accrued rebates	35,329	35,346
Payroll and commissions	24,013	23,035
Total current liabilities	308,951	285,897
Long-term debt	26	79
Other accrued liabilities	18,039	14,561
Accrued asbestos liabilities	35,319	33,376
Total liabilities	362,335	333,913
Commitments and contingencies		
Stockholders' equity:		
Common stock – par value \$2.00 per share:		
Authorized – 30,000,000 shares; issued 23,936,036 shares	47,872	47,872
Capital in excess of par value	104,876	100,057
Retained earnings	381,503	357,153

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Accumulated other comprehensive income	(7,117	)	(4,109	)
Treasury stock – at cost (1,520,524 shares and 1,424,025 shares in 2018 and 2017, respectively)	(53,082	)	(47,319	)
Total stockholders' equity	474,052		453,654	
Total liabilities and stockholders' equity	\$ 836,387		\$ 787,567	

See accompanying notes to consolidated financial statements (unaudited).

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Nine Months Ended September 30, 2018      2017 (Unaudited)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net earnings	\$39,683	\$46,623
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	17,745	17,439
Amortization of deferred financing cost	258	258
Increase to allowance for doubtful accounts	40	889
Increase to inventory reserves	2,753	1,579
Amortization of deferred gain on sale of building	(218 )	(786 )
Equity income from joint ventures	(603 )	(970 )
Employee Stock Ownership Plan allocation	1,918	1,619
Stock-based compensation	5,614	5,663
(Increase) decrease in deferred income taxes	(2,556 )	700
Loss on discontinued operations, net of tax	5,014	5,113
Change in assets and liabilities:		
Increase in accounts receivable	(23,428)	(27,753)
(Increase) decrease in inventories	2,761	(18,746)
(Increase) decrease in prepaid expenses and other current assets	1,202	(4,805 )
Increase in accounts payable	5,193	90
Increase in sundry payables and accrued expenses	12,828	8,728
Net change in other assets and liabilities	(619 )	1,120
Net cash provided by operating activities	67,585	36,761
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisitions of and investments in businesses	(9,852 )	—
Capital expenditures	(15,633)	(17,710)
Other investing activities	37	6
Net cash used in investing activities	(25,448)	(17,704)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net borrowings (payments) under line-of-credit agreements	(12,000)	18,188
Net borrowings (payments) of other debt and capital lease obligations	1,463	(35 )
Purchase of treasury stock	(9,271 )	(20,000)
Increase in overdraft balances	1,382	658
Dividends paid	(14,144)	(12,990)
Net cash used in financing activities	(32,570)	(14,179)
Effect of exchange rate changes on cash	431	724
Net increase in cash and cash equivalents	9,998	5,602
CASH AND CASH EQUIVALENTS at beginning of period	17,323	19,796
CASH AND CASH EQUIVALENTS at end of period	\$27,321	\$25,398

## Supplemental disclosure of cash flow information:

Cash paid during the period for:

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Interest	\$2,896	\$1,456
Income taxes	\$11,829	\$30,181

See accompanying notes to consolidated financial statements (unaudited).

6

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IndexSTANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

Nine Months Ended September 30, 2018

(Unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
(In thousands)						
Balance at December 31, 2017	\$47,872	\$100,057	\$357,153	\$ (4,109 )	\$(47,319)	\$453,654
Cumulative effect adjustment (Note 2)	—	—	(1,189 )	—	—	(1,189 )
Net earnings	—	—	39,683	—	—	39,683
Other comprehensive income (loss), net of tax	—	—	—	(3,008 )	—	(3,008 )
Cash dividends paid	—	—	(14,144 )	—	—	(14,144 )
Purchase of treasury stock	—	—	—	—	(9,115 )	(9,115 )
Stock-based compensation	—	4,054	—	—	1,560	5,614
Employee Stock Ownership Plan	—	765	—	—	1,792	2,557
Balance at September 30, 2018	\$47,872	\$104,876	\$381,503	\$ (7,117 )	\$(53,082)	\$474,052

See accompanying notes to consolidated financial statements (unaudited).

Index

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation

Standard Motor Products, Inc. and subsidiaries (referred to 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 with a complementary focus on heavy duty, industrial equipment and the original equipment service market.

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, 2017. The unaudited consolidated financial statements include our accounts and all domestic and international companies in which we have more than a 50% equity ownership, except in instances where the minority shareholder maintains substantive participating rights, in which case we follow the equity method of accounting. Investments in unconsolidated affiliates are accounted for on the equity method, as we do not have a controlling financial interest but have the ability to exercise significant influence. 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.

Reclassification

Certain prior period amounts in the accompanying consolidated financial statements and related notes have been reclassified to conform to the 2018 presentation.

Note 2. Summary of Significant Accounting Policies

The preparation of consolidated annual and quarterly financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the 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 have made a number of estimates and assumptions in the preparation of these consolidated financial statements. We can give no assurance that actual results will not differ from those estimates. Some of the more significant estimates include allowances for doubtful accounts, realizability of inventory, goodwill and other intangible assets, depreciation and amortization of long-lived assets, product liability, other postretirement benefits, asbestos, environmental and litigation matters, the valuation of deferred tax assets and sales return allowances.

There have been no material changes to our critical accounting policies and estimates from the information provided in Note 1 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017, except for changes made as a result of the adoption of the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers, described under the heading, “Recently Issued Accounting Pronouncements” below and in Note 3, “Net Sales.”



Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Recently Issued Accounting Pronouncements

## Standards that were adopted

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers, (“ASU 2014-09”) which replaces numerous requirements in U.S. generally accepted accounting principles, including industry-specific requirements, and provides companies with a single comprehensive revenue recognition model for recognizing revenue from contracts with customers. Under the new guidance, an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The two permitted transition methods under the new standard are (1) the full retrospective method, in which case the standard would be applied to each prior reporting period presented, with the cumulative effect of applying the standard recognized at the earliest period presented, or (2) the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application.

Effective January 1, 2018, we adopted the requirements of ASU 2014-09, Revenue from Contracts with Customers, using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We expect the impact of the adoption of the new standard to be immaterial to our net income on an ongoing basis.

The adoption of the new standard did not result in a material difference between the recognition of revenue under ASU 2014-09 and prior accounting standards. For the majority of our net sales, revenue continues to be recognized when products are shipped from our distribution facilities, or when received by our customers, depending upon the terms of the contract. Under the new revenue standard, (1) the return of cores from customers used in our manufacturing processes for air conditioning compressors, diesel injectors, and diesel pumps is estimated and recorded as unreturned customer inventories at the time of sale, and (2) overstock returns are recorded gross of expected recoveries. Adoption of the new standard resulted in the recording of unreturned customer inventories, and an increase in accrued core liabilities and accrued customer returns, with partially offsetting changes in net sales and cost of sales, and no material change to our net income on an ongoing basis.

The cumulative effect of the changes made to our consolidated balance sheet as of January 1, 2018 for the adoption of ASU 2014-09 is as follows (in thousands):

	Balance at December 31, 2017	Adjustments Due to Adoption of ASU 2014-09	Balance at January 1, 2018
Balance Sheet			
Unreturned customer inventories	\$ —	\$ 19,950	\$ 19,950
Accrued customer returns	35,916	6,670	42,586
Accrued core liability	11,899	14,469	26,368
Retained earnings	357,153	(1,189 )	355,964



Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

The adoption of ASU 2014-09 resulted in the following changes to our consolidated balance sheet as of September 30, 2018 and our consolidated statement of operations for the three months and nine months ended September 30, 2018 (in thousands):

	As Reported	Balances Without Adoption of ASU 2014-09	Effect of Change			
<b>Balance Sheet</b>						
Unreturned customer inventories	\$ 21,295	\$ —	\$ 21,295			
Prepaid expenses and other current assets	11,681	11,907	(226 )			
Accrued customer returns	53,717	45,934	7,783			
Accrued core liability	30,002	16,165	13,837			
Retained earnings	381,503	382,054	(551 )			
<b>Statement of Operations</b>						
	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	As Reported	Balances Without Adoption of ASU 2014-09	Effect of Change	As Reported	Balances Without Adoption of ASU 2014-09	Effect of Change
Net sales	\$296,619	\$298,440	\$(1,821 )	\$845,081	\$844,449	\$ 632
Cost of sales	209,313	210,930	(1,617 )	603,897	604,129	(232 )
Earnings from continuing operations operations before taxes	26,275	26,479	(204 )	60,498	59,634	864
Provision for income taxes	7,002	7,051	(49 )	15,801	15,575	226
Net earnings	15,749	15,904	(155 )	39,683	39,045	638

See Note 3 for further information regarding our adoption of ASU 2014-09.

The following table provides a brief description of the impact of additional recently adopted accounting pronouncements on our financial statements:

Standard	Description	Date of adoption	Effects on the financial statements or other significant matters
ASU 2016-15, Statement of Cash Flows	This standard is intended to reduce diversity in practice and to provide guidance as to how certain cash receipts and cash payments are presented and classified in the statement of cash flows.	January 1, 2018	The retrospective adoption of the new standard did not result in any changes in our reporting of cash receipts and cash payments in our

ASU 2017-07,  
Improving the  
Presentation of Net  
Periodic Pension Cost  
and Net Periodic  
Postretirement Benefit  
Cost

This standard requires employers that present operating income in their consolidated statement of operations to include only the service cost component of net periodic pension cost and net periodic postretirement benefit cost in operating expenses (together with other employee compensation costs). The other components of net benefit cost, including amortization of prior service cost/credit, and settlement and curtailment effects, are to be included in other non-operating income (expense). The new standard requires retrospective reclassification of the effects of the new standard on the statement of operations.

January 1,  
2018

consolidated statement  
of cash flows.

The adoption of the new standard resulted in the reclassification of all components of net periodic pension cost and net periodic postretirement benefit cost, other than the service cost component, in our statement of operations from selling, general and administrated expenses, to other non-operating income (expense). We adopted the new standard retrospectively, and as such, all prior period amounts have been reclassified for comparative purposes.

Index

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

Standards that are not yet adopted as of September 30, 2018

Leases

In February 2016, the FASB issued ASU 2016-02, Leases, (“ASU 2016-02”), which outlines the need to recognize a right-of-use (“ROU”) asset and a lease liability for all leases with a term longer than twelve months. For income statement purposes, the FASB retained the dual model, requiring leases to be classified as either operating or financing. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. The new standard is effective for annual reporting periods beginning after December 15, 2018, which for us is January 1, 2019, and interim periods within those annual periods. The new standard will require that we recognize all of our leases, including our current operating leases, on the balance sheet. The new standard requires adoption using a modified retrospective approach and provides a number of optional practical expedients in transition.

In July 2018, the FASB issued ASU 2018-11, Targeted Improvements, (“ASU 2018-11”), which provides an alternative modified retrospective transition method. Under this new transition method, a reporting entity would initially apply the new lease requirements at the effective date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Comparative financial information for the prior periods presented would not be restated but instead would continue to be reported under accounting standards in effect in those prior periods.

To date, we have taken an inventory of all of our operating leases, which consists primarily of real estate, equipment and auto leases, have reviewed key lease agreements, and have begun a review of contracts for embedded leases. We continue to evaluate lease terms, lease payments and appropriate discount rates to use in calculating the ROU asset and lease liability. We anticipate using the alternative modified retrospective method of adoption permitted pursuant to ASU 2018-11, whereby financial information will not be updated, and the disclosure required under the new standard will not be provided, for dates and periods before January 1, 2019. In addition, we expect to elect the “package of practical expedients,” which permits us not to reassess under the new standard our prior conclusions about lease identification, lease classification and initial direct costs and permits the use-of-hindsight in determining the lease term.

We do not expect that the adoption of this standard will have a material effect on our statement of operations, or our operating cash flows. While we continue to assess all of the effects of adoption, we currently believe the most significant effects relate to the recognition of new ROU assets and lease liabilities on our balance sheet for our operating leases, and providing significant new disclosures about our leasing activities. We do not expect a significant change in our leasing activities between now and adoption, and will be continuously assessing the impact of the new standard on our systems, processes and controls through January 1, 2019, our planned adoption date.

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

The following table provides a brief description of additional recently issued accounting pronouncements that have not yet been adopted as of September 30, 2018, and that could have an impact on our financial statements:

Standard	Description	Date of adoption	Effects on the financial statements or other significant matters
ASU 2017-04, Simplifying the Test for Goodwill Impairment	This standard is intended to simplify the accounting for goodwill impairment. ASU 2017-04 removes Step 2 of the test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill.	January 1, 2020, with early adoption permitted	The new standard should be applied prospectively. We will consider the new standard when performing our annual impairment test and evaluate when we will adopt the new standard.
ASU 2016-13, Financial Instruments – Credit Losses	This standard creates a single model to measure impairment on financial assets, which includes trade account receivables. An estimate of expected credit losses on trade account receivables over their contractual life will be required to be recorded at inception, based on historical information, current conditions, and reasonable and supportable forecasts.	January 1, 2020, with early adoption permitted	We do not anticipate that the adoption of this standard will have a material impact on manner in which we estimate our allowance for doubtful accounts on trade accounts receivable, or on our consolidated financial statements.

## Note 3. Net Sales

## Significant Accounting Policy

We recognize revenues when our performance obligation has been satisfied and the control of products has been transferred to a customer which typically occurs upon shipment. Revenue is measured as the amount of consideration we expect to receive in exchange for the transfer of goods or providing services. Shipping and handling costs, as well as freight to customers, are included in distribution expenses as part of selling, general and administrative expenses.

## Revenue Recognition

We derive our revenue primarily from sales of replacement parts for motor vehicles from both our Engine Management and Temperature Control Segments. The amount of consideration we receive and revenue we recognize depends on the marketing incentives, product warranty and overstock returns we offer to our customers. For certain 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 at the time of the sale but rather carried as a core liability. At the same time, we estimate the core expected to be returned from the customer and record the estimated return as unreturned customer inventory. The liability is extinguished when a core is actually returned to us, or at period end when we estimate and recognize revenue for the core deposits not expected to be returned. 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. Significant management judgments and estimates must be made and used in estimating sales returns and allowances relating to revenue recognized in any accounting period.

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Product 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 and/or the result of installation error. In addition to warranty returns, we also permit our customers to return new, undamaged 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. At the time products are sold, we accrue a liability for product warranties and overstock returns as a percentage of sales based upon estimates established using historical information on the nature, frequency and average cost of the claim and the probability of the customer return. At the same time, we record an estimate of anticipated customer returns as unreturned customer inventory. Revision to these estimates is made when necessary, based upon changes in these factors. We regularly study trends of such claims.

## Disaggregation of Net Sales

We disaggregate our net sales from contracts with customers by geographic area, major product group, and major sales channels for each of our segments, as we believe it best depicts how the nature, amount, timing and uncertainty of our net sales are affected by economic factors. The following tables provide disaggregation of net sales information for the three months and nine months ended September 30, 2018 and 2017 (in thousands):

Three months ended September 30, 2018 (a)	Engine Management	Temperature Control	Other (c)	Total
<b>Geographic Area:</b>				
United States	\$ 175,875	\$ 91,687	\$ —	\$267,562
Canada	9,297	3,591	2,970	15,858
Mexico	4,909	219	—	5,128
Europe	2,041	156	—	2,197
Other foreign	5,448	426	—	5,874
Total	\$ 197,570	\$ 96,079	\$ 2,970	\$296,619
<b>Major Product Group:</b>				
Ignition, emissions and fuel system parts	\$ 159,101	\$ —	\$ 1,171	\$160,272
Wire and cable	38,469	—	118	38,587
Compressors	—	54,842	1,070	55,912
Other climate control parts	—	41,237	611	41,848
Total	\$ 197,570	\$ 96,079	\$ 2,970	\$296,619
<b>Major Sales Channel:</b>				
Aftermarket	\$ 168,836	\$ 88,681	\$ 2,970	\$260,487
OE/OES	23,345	6,718	—	30,063
Export	5,389	680	—	6,069
Total	\$ 197,570	\$ 96,079	\$ 2,970	\$296,619

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Three months ended September 30, 2017 (a)(b)	Engine Management	Temperature Control	Other (c)	Total
Geographic Area:				
United States	\$ 172,530	\$ 77,315	\$ —	\$249,845
Canada	8,023	3,087	3,122	14,232
Mexico	6,190	291	—	6,481
Europe	3,157	131	—	3,288
Other foreign	6,876	336	—	7,212
Total	\$ 196,776	\$ 81,160	\$ 3,122	\$281,058
Major Product Group:				
Ignition, emissions and fuel system parts	\$ 155,544	\$ —	\$ 1,526	\$157,070
Wire and cable	41,232	—	167	41,399
Compressors	—	44,733	972	45,705
Other climate control parts	—	36,427	457	36,884
Total	\$ 196,776	\$ 81,160	\$ 3,122	\$281,058
Major Sales Channel:				
Aftermarket	\$ 163,634	\$ 73,664	\$ 3,122	\$240,420
OE/OES	26,891	6,584	—	33,475
Export	6,251	912	—	7,163
Total	\$ 196,776	\$ 81,160	\$ 3,122	\$281,058

Nine months ended September 30, 2018 (a)	Engine Management	Temperature Control	Other (c)	Total
Geographic Area:				
United States	\$ 532,842	\$ 223,861	\$ —	\$756,703
Canada	24,389	10,685	7,914	42,988
Mexico	17,578	610	—	18,188
Europe	7,927	469	—	8,396
Other foreign	17,751	1,055	—	18,806
Total	\$ 600,487	\$ 236,680	\$ 7,914	\$845,081
Major Product Group:				
Ignition, emissions and fuel system parts	\$ 482,640	\$ —	\$ 4,024	\$486,664
Wire and cable	117,847	—	467	118,314
Compressors	—	131,680	1,832	133,512
Other climate control parts	—	105,000	1,591	106,591
Total	\$ 600,487	\$ 236,680	\$ 7,914	\$845,081
Major Sales Channel:				
Aftermarket	\$ 510,010	\$ 210,990	\$ 7,914	\$728,914
OE/OES	74,202	24,115	—	98,317
Export	16,275	1,575	—	17,850
Total	\$ 600,487	\$ 236,680	\$ 7,914	\$845,081

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Nine months ended September 30, 2017 (a)(b)	Engine Management	Temperature Control	Other (c)	Total
<b>Geographic Area:</b>				
United States	\$ 559,574	\$ 226,041	\$ —	\$785,615
Canada	25,846	10,155	5,885	41,886
Mexico	18,277	731	—	19,008
Europe	10,122	658	—	10,780
Other foreign	17,620	1,256	—	18,876
<b>Total</b>	<b>\$ 631,439</b>	<b>\$ 238,841</b>	<b>\$ 5,885</b>	<b>\$876,165</b>
<b>Major Product Group:</b>				
Ignition, emissions and fuel system parts	\$ 498,802	\$ —	\$ 3,083	\$501,885
Wire and cable	132,637	—	550	133,187
Compressors	—	132,278	1,271	133,549
Other climate control parts	—	106,563	981	107,544
<b>Total</b>	<b>\$ 631,439</b>	<b>\$ 238,841</b>	<b>\$ 5,885</b>	<b>\$876,165</b>
<b>Major Sales Channel:</b>				
Aftermarket	\$ 535,245	\$ 212,262	\$ 5,885	\$753,392
OE/OES	79,563	24,383	—	103,946
Export	16,631	2,196	—	18,827
<b>Total</b>	<b>\$ 631,439</b>	<b>\$ 238,841</b>	<b>\$ 5,885</b>	<b>\$876,165</b>

(a) Segment net sales include intersegment sales in our Engine Management and Temperature Control segments.

(b) Amounts have not been restated and are reported under accounting standards in effect in the period presented as we adopted ASU 2014-09, Revenue from Contracts with Customers, using the modified retrospective method.

Other consists of the elimination of intersegment sales from our Engine Management and Temperature Control (c) segments as well as sales from our Canadian business unit that does not meet the criteria of a reportable operating segment.

**Geographic Area**

We sell our line of products primarily in the United States, with additional sales in Canada, Mexico, Europe, Asia and Latin America. Sales are attributed to countries based upon the location of the customer. Our sales are substantially denominated in U.S. dollars.

**Major Product Group**

The Engine Management segment of the Company principally generates revenue from the sale of automotive engine replacement parts including ignition, emission and fuel system parts, and wire and cable parts. The Temperature Control segment of the Company principally generates revenue from the sale of automotive temperature control systems replacement parts including air conditioning compressors and other climate control parts.

**Major Sales Channel**

In the aftermarket channel, we sell our products to warehouse distributors and retailers. Our customers buy directly from us and sell directly to jobber stores, professional technicians and to “do-it-yourselfers” who perform automotive repairs on their personal vehicles. In the Original Equipment (“OE”) and Original Equipment Service (“OES”) channel, we sell our products to original equipment manufacturers who redistribute our products within their distribution network, independent dealerships and service dealer technicians. Lastly, in the Export channel, our domestic entities sell to customers outside the United States.

15

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Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 4. Business Acquisitions and Investments

## 2018 Increase in Equity Investment

Foshan GWO YNG SMP Vehicle Climate Control & Cooling Products Co. Ltd.

In April 2014, we formed a 50/50 joint venture with Gwo Yng Enterprise Co., Ltd. (“Gwo Yng”), a China-based manufacturer of air conditioner accumulators, filter driers, hose assemblies and switches for the automotive aftermarket and OEM/OES markets. We acquired our 50% interest in the joint venture for approximately \$14 million. We determined, at that time, that due to a lack of a voting majority and other qualitative factors, we do not control the operations of the joint venture and accordingly, our investment in the joint venture was accounted for under the equity method of accounting.

In March 2018, we acquired an additional 15% equity interest in the joint venture for RMB 26,475,583 (approximately \$4.2 million), thereby increasing our equity interest in the joint venture to 65%. The \$4.2 million payment for our additional 15% investment was made in cash installments through September 30, 2018. Although we have increased our equity interest in the joint venture to 65%, the minority shareholder will maintain participating rights that will allow it to participate in certain significant financial and operating decisions that occur in the ordinary course of business. As a result of the existence of these substantive participating rights of the minority shareholder, we will continue to account for our investment in the joint venture under the equity method of accounting.

## 2017 Equity Investment

Foshan FGD SMP Automotive Compressor Co., Ltd.

In November 2017, we formed a 50/50 joint venture with Foshan Guangdong Automotive Air Conditioning Co., Ltd. (“FGD”), a China-based manufacturer of air conditioning compressors for the automotive aftermarket and the Chinese OE market. We acquired our 50% interest in the joint venture for approximately \$12.5 million. Payment for our acquired interest in the joint venture was made in installments with approximately \$6.8 million paid in 2017 and the balance of approximately \$5.7 million paid in January 2018. We determined that due to a lack of a voting majority, and other qualitative factors, we do not control the operations of the joint venture and accordingly, our investment in the joint venture is accounted for under the equity method of accounting.

## Note 5. Restructuring and Integration Expenses

The aggregated liabilities included in “sundry payables and accrued expenses” and “other accrued liabilities” in the consolidated balance sheet relating to the restructuring and integration activities as of December 31, 2017 and September 30, 2018 and activity for the nine months ended September 30, 2018 consisted of the following (in thousands):

	Workforce Reduction	Other Exit Costs	Total
Exit activity liability at December 31, 2017	\$ 2,854	\$ —	\$2,854
Restructuring and integration costs:			
Amounts provided for during 2018	9	3,064	3,073
Non-cash usage, including asset write-downs	—	(181 )	(181 )

Cash payments	(2,077 )	(2,883 )	(4,960)
Foreign currency exchange rate changes	26	—	26
Exit activity liability at September 30, 2018	\$ 812	\$ —	\$ 812

#### Restructuring Costs

##### Plant Rationalization Program

In February 2016, in connection with our ongoing efforts to improve operating efficiencies and reduce costs, we finalized our intention to implement a plant rationalization initiative. As part of the plant rationalization, all our Grapevine, Texas production activities have been relocated to facilities in Greenville, South Carolina and Reynosa, Mexico, and certain production activities were relocated from our Greenville, South Carolina manufacturing facility to our manufacturing facility in Bialystok, Poland. In addition, certain service functions were relocated from Grapevine, Texas to our administrative offices in Lewisville, Texas and our Grapevine, Texas facility was closed. As of September 30, 2018, the plant rationalization program is substantially completed. Cash payments made during the first nine months of 2018 consisted primarily of severance payments to employees.

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Activity, by segment, for the nine months ended September 30, 2018 related to our plant rationalization program consisted of the following (in thousands):

	Engine Management	Temperature Control	Other	Total
Exit activity liability at December 31, 2017	\$ —	\$ 1,476	\$ —	\$ 1,476
Restructuring and integration costs:				
Amounts provided for during 2018	—	202	—	202
Cash payments	—	(1,338 )	—	(1,338)
Exit activity liability at September 30, 2018	\$ —	\$ 340	\$ —	\$ 340

## Orlando Plant Rationalization Program

In January 2017, to further our ongoing efforts to improve operating efficiencies and reduce costs, we finalized our intention to implement a plant rationalization initiative at our Orlando, Florida facility. As part of the Orlando plant rationalization, all of our Orlando, Florida production activities have been relocated to our Independence, Kansas manufacturing facility. In addition, certain production activities were relocated from our Independence, Kansas manufacturing facility to our Reynosa, Mexico manufacturing facility and our Orlando, Florida facility was closed. As of September 30, 2018, the Orlando plant rationalization program is substantially completed. The remaining aggregate liability related to the program as of September 30, 2018 consists of future cash severance payments to be made to former employees.

Activity, by segment, for the nine months ended September 30, 2018 related to our Orlando plant rationalization program consisted of the following (in thousands):

	Engine Management	Temperature Control	Other	Total
Exit activity liability at December 31, 2017	\$ 986	\$ —	\$ —	\$ 986
Restructuring and integration costs:				
Amounts provided for during 2018	1,479	—	—	1,479
Non-cash usage, including asset write-downs	(12 )	—	—	(12 )
Cash payments	(1,981 )	—	—	(1,981)
Exit activity liability at September 30, 2018	\$ 472	\$ —	\$ —	\$ 472

## Integration Costs

## Wire and Cable Relocation

In connection with our acquisition of the North American automotive ignition wire business of General Cable Corporation in May 2016, we incurred certain integration expenses, including costs incurred in connection with the consolidation of the General Cable Corporation Altoona, Pennsylvania wire distribution center into our existing wire distribution center in Edwardsville, Kansas and the relocation of certain machinery and equipment. In October 2016, we further announced our plan to relocate all production from the acquired Nogales, Mexico wire set assembly operation to our existing wire assembly facility in Reynosa, Mexico and to close the Nogales, Mexico plant. As of September 30, 2018, the wire and cable relocation program is substantially completed. All of our Nogales, Mexico production activities have been relocated to our Reynosa, Mexico assembly facility and our Nogales, Mexico plant

was closed.

17

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Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Activity, by segment, for the nine months ended September 30, 2018 related to our wire and cable relocation program consisted of the following (in thousands):

	Engine Management	Temperature Control	Other	Total
Exit activity liability at December 31, 2017	\$ 392	\$ —	\$ —	\$392
Restructuring and integration costs:				
Amounts provided for during 2018	1,392	—	—	1,392
Non-cash usage, including asset write-downs	(169 )	—	—	(169 )
Cash payments	(1,641 )	—	—	(1,641)
Foreign currency exchange rate changes	26	—	—	26
Exit activity liability at September 30, 2018	\$ —	\$ —	\$ —	\$—

## Note 6. Sale of Receivables

From time to time, we sell undivided interests in certain of our receivables to financial institutions. We enter these agreements at our discretion when we determine that the cost of factoring is less than the cost of servicing our receivables with existing debt. Under the terms of the agreements, we retain no rights or interest, have no obligations with respect to the sold receivables, and do not service the receivables after the sale. As such, these transactions are being accounted for as a sale.

Pursuant to these agreements, we sold \$224.4 million and \$566 million of receivables during the three months and nine months ended September 30, 2018, respectively, and \$210.6 million and \$614.6 million for the comparable periods in 2017. A charge in the amount of \$7.3 million and \$19 million related to the sale of receivables is included in selling, general and administrative expense in our consolidated statements of operations for the three months and nine months ended September 30, 2018, respectively, and \$6 million and \$17.6 million for the comparable periods in 2017. If we do not enter into these arrangements or if any of the financial institutions with which we enter into these arrangements were to experience financial difficulties or otherwise terminate these arrangements, our financial condition, results of operations and cash flows could be materially and adversely affected by delays or failures to collect future trade accounts receivable.

## Note 7. Inventories

Inventories, which are stated at the lower of cost (determined by means of the first-in, first-out method) or market, consist of the following:

	September 30, 2018	December 31, 2017
	(In thousands)	
Finished goods	\$202,976	\$ 209,800
Work-in-process	9,287	7,536
Raw materials	106,157	109,075
Subtotal	318,420	326,411
Unreturned customer inventories (1)	21,295	—

Total inventories                      \$339,715    \$ 326,411

The adoption of ASU 2014-09 using the modified retrospective method resulted in the recording of unreturned (1)customer inventories commencing on January 1, 2018, see Note 2, “Summary of Significant Accounting Policies” for additional information.

18

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Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 8. Acquired Intangible Assets

Acquired identifiable intangible assets consist of the following:

	September 30, 2018	December 31, 2017
	(In thousands)	
Customer relationships	\$87,290	\$ 87,290
Trademarks and trade names	6,800	6,800
Non-compete agreements	3,197	3,193
Patents	723	723
Supply agreements	800	800
Leaseholds	160	160
Total acquired intangible assets	98,970	98,966
Less accumulated amortization (1)	(49,587)	(43,853)
Net acquired intangible assets	\$49,383	\$ 55,113

(1) Applies to all intangible assets, except for trademarks and trade names totaling \$5.2 million, which have indefinite useful lives and, as such, are not being amortized.

Total amortization expense for acquired intangible assets was \$1.9 million and \$5.7 million for the three months and nine months ended September 30, 2018, respectively, and \$1.9 million and \$6.1 million for the comparable periods in 2017. Based on the current estimated useful lives assigned to our acquired intangible assets, amortization expense is estimated to be \$1.8 million for the remainder of 2018, \$6.3 million in 2019, \$5.9 million in 2020, \$4.6 million in 2021 and \$25.6 million in the aggregate for the years 2022 through 2031.

## Note 9. Credit Facilities and Long-Term Debt

Total debt outstanding is summarized as follows:

	September 30, 2018	December 31, 2017
	(In thousands)	
Revolving credit facilities	\$45,000	\$ 57,000
Other (1)	6,006	4,778
Total debt	\$51,006	\$ 61,778
Current maturities of debt	\$50,980	\$ 61,699
Long-term debt	26	79
Total debt	\$51,006	\$ 61,778

(1)

Other includes borrowings under our Polish overdraft facility of Zloty 21.7 million (approximately \$5.9 million) and Zloty 16.2 million (approximately \$4.7 million) as of September 30, 2018 and December 31, 2017, respectively.

Index

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

Revolving Credit Facility

In October 2015, we entered into a Credit Agreement with JPMorgan Chase Bank, N.A., as agent, and a syndicate of lenders for a senior secured revolving credit facility with a line of credit of up to \$250 million (with an additional \$50 million accordion feature) and a maturity date in October 2020. The line of credit under the agreement also allows for a \$10 million line of credit to Canada as part of the \$250 million available for borrowing. Direct borrowings under the credit agreement bear interest at LIBOR plus a margin ranging from 1.25% to 1.75% based on our borrowing availability, or floating at the alternate base rate plus a margin ranging from 0.25% to 0.75% based on our borrowing availability, at our option. The credit agreement is guaranteed by certain of our subsidiaries and secured by certain of our assets.

Borrowings under the credit agreement are secured by substantially all of our assets, including accounts receivable, inventory and certain fixed assets, and those of certain of our subsidiaries. Availability under the credit agreement is based on a formula of eligible accounts receivable, eligible inventory, eligible equipment and eligible fixed assets. After taking into account outstanding borrowings under the credit agreement, there was an additional \$201.8 million available for us to borrow pursuant to the formula at September 30, 2018. Outstanding borrowings under the credit agreement, which are classified as current liabilities, were \$45 million and \$57 million at September 30, 2018 and December 31, 2017, respectively. Borrowings under the credit agreement have been classified as current liabilities based upon the accounting rules and certain provisions in the agreement.

At September 30, 2018, the weighted average interest rate on our credit agreement was 3.4%, which consisted of \$45 million in direct borrowings. At December 31, 2017, the weighted average interest rate on our credit agreement was 2.7%, which consisted of \$57 million in direct borrowings. During the nine months ended September 30, 2018, our average daily alternative base rate loan balance was \$2 million, compared to a balance of \$4.6 million for the nine months ended September 30, 2017, and a balance of \$3.8 million for the year ended December 31, 2017.

At any time that our borrowing availability is less than the greater of either (a) \$25 million, or 10% of the commitments if fixed assets are not included in the borrowing base, or (b) \$31.25 million, or 12.5% of the commitments if fixed assets are included in the borrowing base, the terms of the credit agreement provide for, among other provisions, a financial covenant requiring us, on a consolidated basis, to maintain a fixed charge coverage ratio of 1:1 at the end of each fiscal quarter (rolling four quarters). As of September 30, 2018, we were not subject to these covenants. The credit agreement permits us to pay cash dividends of \$20 million and make stock repurchases of \$20 million in any fiscal year subject to a minimum availability of \$25 million. Provided specific conditions are met, the credit agreement also permits acquisitions, permissible debt financing, capital expenditures, and cash dividend payments and stock repurchases of greater than \$20 million.

Polish Overdraft Facility

In December 2017, our Polish subsidiary, SMP Poland sp. z.o.o., entered into an overdraft facility with HSBC Bank Polska S.A. (“HSBC Poland”) for Zloty 30 million (approximately \$8 million). The facility expires in December 2018. Borrowings under the overdraft facility will bear interest at a rate equal to WIBOR + 0.75% and are guaranteed by Standard Motor Products, Inc., the ultimate parent company. At September 30, 2018, borrowings under the overdraft facility were Zloty 21.7 million (approximately \$5.9 million).

Deferred Financing Costs

We had deferred financing costs of \$0.7 million and \$1 million as of September 30, 2018 and December 31, 2017, respectively. Deferred financing costs are related to our revolving credit facility. Deferred financing costs as of September 30, 2018 are being amortized in the amounts of \$0.1 million for the remainder of 2018, \$0.3 million in 2019 and \$0.3 million in 2020.

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 10. Accumulated Other Comprehensive Income

## Changes in Accumulated Other Comprehensive Income by Component (in thousands)

	Three Months Ended September 30, 2018		
	Foreign Currency Translation Adjustments	Unrecognized Postretirement Benefit Costs (Credit)	Total
Balance at June 30, 2018	\$ (7,941 )	\$ 111	\$ (7,830 )
Other comprehensive income before reclassifications	719	—	719
Amounts reclassified from accumulated other comprehensive income	—	(6 )	(6 )
Other comprehensive income, net	719	(6 )	713
Balance at September 30, 2018	\$ (7,222 )	\$ 105	\$ (7,117 )

	Nine Months Ended September 30, 2018		
	Foreign Currency Translation Adjustments	Unrecognized Postretirement Benefit Costs (Credit)	Total
Balance at December 31, 2017	\$ (4,225 )	\$ 116	\$ (4,109 )
Other comprehensive income before reclassifications	(2,997 )	7	(2,990 )
Amounts reclassified from accumulated other comprehensive income	—	(18 )	(18 )
Other comprehensive income, net	(2,997 )	(11 )	(3,008 )
Balance at September 30, 2018	\$ (7,222 )	\$ 105	\$ (7,117 )

## Reclassifications Out of Accumulated Other Comprehensive Income (in thousands)

Details About Accumulated Other Comprehensive Income Components	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Amortization of postretirement benefit plans:		
Prior service benefit (1)	\$ —	\$ —
Unrecognized (gain) loss (1)	(10 )	(31 )
Total before income tax	(10 )	(31 )
Income tax expense	4	13
Total reclassifications for the period	\$ (6 )	\$ (18 )

These accumulated other comprehensive income components are included in the computation of net periodic (1) postretirement benefit costs, which are included in other non-operating income, net in our consolidated statements of operations (see Note 12 for additional details).

## Note 11. Stock-Based Compensation Plans

We account for our stock-based compensation plans in accordance with the provisions of FASB ASC 718, Stock Compensation, which requires that a company measure the cost of employee services received in exchange for an

award of equity instruments based on the grant-date fair value of the award. The cost is recognized in the consolidated statement of operations over the period during which an employee is required to provide service in exchange for the award.

21

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Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Restricted and Performance Stock Grants

As part of the 2016 Omnibus Incentive Plan, we currently grant shares of restricted stock to eligible employees and our independent directors and performance-based stock to eligible employees. Selected executives and other key personnel are granted performance awards whose vesting is contingent upon meeting various performance measures with a retention feature. Performance-based shares are subject to a three-year measuring period and the achievement of performance targets and, depending upon the achievement of such performance targets, they may become vested on the third anniversary of the date of grant. Each period we evaluate the probability of achieving the applicable targets, and we adjust our accrual accordingly. Restricted shares granted to employees become fully vested upon the third anniversary of the date of grant; and for selected key executives, certain additional restricted share grants vest 25% upon the attainment of age 60, 25% upon the attainment of age 63 and become fully vested upon the attainment of age 65. Restricted shares granted to directors become fully vested upon the first anniversary of the date of grant. Commencing with the 2015 grants, restricted and performance shares issued to certain key executives and directors are subject to a one or two year holding period upon the lapse of the three year vesting period. Forfeitures on restricted stock grants are estimated at 5% for employees and 0% for executives and directors, respectively, based on our evaluation of historical and expected future turnover.

Our restricted and performance-based share activity was as follows for the nine months ended September 30, 2018:

	Shares	Weighted Average Grant Date Fair Value Per Share
Balance at December 31, 2017	853,958	\$ 33.25
Granted	9,129	37.53
Vested	(32,471 )	32.89
Forfeited	(9,850 )	42.29
Balance at September 30, 2018	820,766	\$ 33.20

We recorded compensation expense related to restricted shares and performance-based shares of \$5 million (\$3.7 million, net of tax) and \$5.1 million (\$3.2 million, net of tax) for the nine months ended September 30, 2018 and 2017, respectively. The unamortized compensation expense related to our restricted and performance-based shares was \$11.1 million at September 30, 2018, and is expected to be recognized as they vest over a weighted average period of 4.0 years and 0.6 years for employees and directors, respectively.

## Note 12. Employee Benefits

We provided, and continue to provide, certain medical and dental care benefits to eligible retired U.S. and Canadian employees. Under the U.S. plan, for non-union employees, a Health Reimbursement Account (“HRA”) was established beginning January 1, 2009 for each qualified U.S. retiree. Annually, and through the year ended December 31, 2016, a fixed amount was credited into the HRA to cover both medical and dental costs for all current and future eligible retirees. Under the Canadian plan, retiree medical and dental benefits were funded using insurance contracts. Premiums under the insurance contracts were funded on a pay-as-you-go basis. The postretirement medical plans to substantially all eligible U.S. and Canadian employees terminated on December 31, 2016. For U.S. plan participants, balances in the HRA accounts upon termination of the plan at December 31, 2016 will remain available for use until December 31, 2018. Any remaining balance at December 31, 2018 will be forfeited. Postretirement medical and dental benefits to eligible employees will continue to be provided to the 20 former union employees in the U.S.



Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

The components of net periodic benefit cost for our postretirement benefit plans for the three months and nine months ended September 30, 2018 and 2017 were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017 (1)	2018	2017 (1)
Postretirement benefits				
Service cost	\$ —	\$ —	\$ —	\$ —
Interest cost	2	2	5	6
Amortization of prior service cost	—	—	—	—
Actuarial net loss	(10 )	(165 )	(31 )	(496 )
Net periodic benefit cost (credit)	\$ (8 )	\$ (163 )	\$ (26 )	\$ (490 )

Net periodic benefit cost (credit) has been reclassified from selling, general and administrative expenses to other non-operating income (expense), net on our consolidated statement of operations upon adoption of ASU 2017-07, (1) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, see Note 2, “Summary of Significant Accounting Policies” for additional information.

We maintain a defined contribution Supplemental Executive Retirement Plan for key employees. Under the plan, these employees may elect to defer a portion of their compensation and, in addition, we may at our discretion make contributions to the plan on behalf of the employees. In March 2018, we made company contributions to the plan of \$0.6 million related to calendar year 2017.

We also have an Employee Stock Ownership Plan and Trust for employees who are not covered by a collective bargaining agreement. In connection therewith, we maintain an employee benefits trust to which we contribute shares of treasury stock. We are authorized to instruct the trustees to distribute such shares toward the satisfaction of our future obligations under the plan. 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 nine months ended September 30, 2018, we contributed to the trust an additional 53,300 shares from our treasury and released 53,300 shares from the trust leaving 200 shares remaining in the trust as of September 30, 2018.

## Note 13. Fair Value Measurements

The carrying value of our financial instruments consisting of cash and cash equivalents, deferred compensation, and short term borrowings approximate their fair value. In each instance, fair value is determined after considering Level 1 inputs under the three-level fair value hierarchy. For fair value purposes, the carrying value of cash and cash equivalents approximates fair value due to the short maturity of those investments. The fair value of the assets held by the deferred compensation plan are based on the quoted market prices of the underlying funds which are held in registered investment companies. The carrying value of our revolving credit facilities, classified as short term borrowings, equals fair market value because the interest rate reflects current market rates.

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 14. 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 per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Basic Net Earnings Per Common Share:</b>				
Earnings from continuing operations	\$ 19,273	\$ 17,108	\$ 44,697	\$ 51,736
Loss from discontinued operations	(3,524 )	(3,983 )	(5,014 )	(5,113 )
Net earnings available to common stockholders	\$ 15,749	\$ 13,125	\$ 39,683	\$ 46,623
Weighted average common shares outstanding	22,425	22,660	22,465	22,775
Earnings from continuing operations per common share	\$ 0.86	\$ 0.75	\$ 1.99	\$ 2.27
Loss from discontinued operations per common share	(0.16 )	(0.17 )	(0.22 )	(0.22 )
Basic net earnings per common share	\$ 0.70	\$ 0.58	\$ 1.77	\$ 2.05
<b>Diluted Net Earnings Per Common Share:</b>				
Earnings from continuing operations	\$ 19,273	\$ 17,108	\$ 44,697	\$ 51,736
Loss from discontinued operations	(3,524 )	(3,983 )	(5,014 )	(5,113 )
Net earnings available to common stockholders	\$ 15,749	\$ 13,125	\$ 39,683	\$ 46,623
Weighted average common shares outstanding	22,425	22,660	22,465	22,775
Plus incremental shares from assumed conversions:				
Dilutive effect of restricted stock and performance-based stock	514	515	490	512
Weighted average common shares outstanding –Diluted	22,939	23,175	22,955	23,287
Earnings from continuing operations per common share	\$ 0.84	\$ 0.74	\$ 1.95	\$ 2.22
Loss from discontinued operations per common share	(0.15 )	(0.17 )	(0.22 )	(0.22 )
Diluted net earnings per common share	\$ 0.69	\$ 0.57	\$ 1.73	\$ 2.00

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 or because they were excluded under the treasury method (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Restricted and performance-based shares	210	218	246	232

Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 15. Industry Segments

We have two major reportable operating segments, each of which focuses on a specific line of replacement parts. Our Engine Management Segment manufactures and remanufactures ignition and emission parts, ignition wires, battery cables, fuel system parts and sensors for vehicle systems. Our Temperature Control Segment manufactures and remanufactures air conditioning compressors, air conditioning and heating parts, engine cooling system parts, power window accessories and windshield washer system parts.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net Sales (a)				
Engine Management	\$197,570	\$196,776	\$600,487	\$631,439
Temperature Control	96,079	81,160	236,680	238,841
All Other	2,970	3,122	7,914	5,885
Consolidated	\$296,619	\$281,058	\$845,081	\$876,165
Intersegment Revenue (a)				
Engine Management	\$6,500	\$6,207	\$17,472	\$19,350
Temperature Control	2,444	1,952	6,264	6,076
All Other	(8,944 )	(8,159 )	(23,736 )	(25,426 )
Consolidated	\$—	\$—	\$—	\$—
Operating Income				
Engine Management	\$21,635	\$22,729	\$62,149	\$76,503
Temperature Control	8,571	7,714	14,284	19,943
All Other	(3,028 )	(3,687 )	(13,598 )	(14,829 )
Consolidated	\$27,178	\$26,756	\$62,835	\$81,617

(a) Segment net sales include intersegment sales in our Engine Management and Temperature Control segments.

For the disaggregation of our net sales from contracts with customers by geographic area, major product group and major sales channels for each of our segments, see Note 3, “Net Sales.”

## Note 16. 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 2001. Our ultimate exposure will depend upon the number of claims filed against us on or after September

2001 and the amounts paid for indemnity and defense thereof. At September 30, 2018, approximately 1,450 cases were outstanding for which we may be responsible for any related liabilities. Since inception in September 2001 through September 30, 2018, the amounts paid for settled claims are approximately \$25.2 million.

25

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Index

STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

In evaluating our potential asbestos-related liability, we have considered various factors including, among other things, an actuarial study of the asbestos related liabilities performed by an independent actuarial firm, our settlement amounts and whether there are any co-defendants, the jurisdiction in which lawsuits are filed, and the status and results of settlement discussions. As is our accounting policy, we consider the advice of actuarial consultants with experience in assessing asbestos-related liabilities to estimate our potential claim liability. The methodology used to project asbestos-related liabilities and costs in our actuarial study considered: (1) historical data available from publicly available studies; (2) an analysis of our recent claims history to estimate likely filing rates into the future; (3) an analysis of our currently pending claims; and (4) an analysis of our settlements to date in order to develop average settlement values.

The most recent actuarial study was performed as of August 31, 2018. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$37.1 million to \$56.9 million for the period through 2061. The change from the prior year study was a \$1.9 million increase for the low end of the range and a \$2.9 million increase for the high end of the range. The increase in the estimated undiscounted liability from the prior year study at both the low end and high end of the range reflects our actual experience over the prior twelve months, our historical data and certain assumptions with respect to events that may occur in the future. Based on the information contained in the actuarial study and all other available information considered by us, we have concluded that no amount within the range of settlement payments was more likely than any other and, therefore, in assessing our asbestos liability we compare the low end of the range to our recorded liability to determine if an adjustment is required. Based upon the results of the August 31, 2018 actuarial study, in September 2018 we increased our asbestos liability to \$37.1 million, the low end of the range, and recorded an incremental pre-tax provision of \$3.5 million in earnings (loss) from discontinued operations in the accompanying statement of operations. Future legal costs, which are expensed as incurred and reported in earnings (loss) from discontinued operations in the accompanying statement of operations, are estimated, according to the updated study, to range from \$44.9 million to \$80.6 million for the period through 2061.

We plan to perform an annual actuarial evaluation during the third quarter of each year for the foreseeable future. Given the uncertainties associated with projecting such matters into the future and other factors outside our control, we can give no assurance that additional provisions will not be required. We 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.

Other Litigation

We are currently involved in various other legal claims and legal proceedings (some of which may involve substantial amounts), including claims related to commercial disputes, product liability, employment, and environmental. Although these legal claims and legal proceedings are subject to inherent uncertainties, based on our understanding and evaluation of the relevant facts and circumstances, we believe that the ultimate outcome of these matters will not, either individually or in the aggregate, have a material adverse effect on our business, financial condition or results of operations. We may at any time determine that settling any of these matters is in our best interests, which settlement may include substantial payments. Although we cannot currently predict the specific amount of any liability that may ultimately arise with respect to any of these matters, we will record provisions when the liability is considered probable and reasonably estimable. Significant judgment is required in both the determination of probability and the determination as to whether an exposure can be reasonably estimated. As additional information becomes available, we reassess our potential liability related to these matters. Such revisions of the potential liabilities could have a

material adverse effect on our business, financial condition or results of operations.

26

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Index

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Warranties

We generally warrant our products against certain manufacturing and other defects. These product warranties are provided for specific periods of time of the product depending on the nature of the product. As of September 30, 2018 and 2017, we have accrued \$24.1 million and \$24.8 million, respectively, for estimated product warranty claims included in accrued customer returns. The accrued product warranty costs are based primarily on historical experience of actual warranty claims.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Balance, beginning of period	\$21,705	\$24,528	\$20,929	\$24,072
Liabilities accrued for current year sales	25,748	25,023	70,126	76,446
Settlements of warranty claims	(23,396)	(24,713)	(66,998)	(75,680)
Balance, end of period	\$24,057	\$24,838	\$24,057	\$24,838

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

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements in this Report are indicated by words such as “anticipates,” “expects,” “believes,” “intends,” “plans,” “estimates,” “projects,” “strategies” 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, changes in business relationships with our major customers and in the timing, size and continuation of our customers’ programs; changes in our receivables factoring arrangements, such as changes in terms, termination of contracts and/or the impact of rising interest rates; the ability of our customers to achieve their projected sales; competitive product and pricing pressures; increases in production or material costs that cannot be recouped in product pricing; the performance of the aftermarket, heavy duty, industrial equipment and original equipment markets; changes in the product mix and distribution channel mix; economic and market conditions; successful integration of acquired businesses; our ability to achieve benefits from our cost savings initiatives; product liability and environmental matters (including, without limitation, those related to asbestos-related contingent liabilities and remediation costs at certain properties); 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 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 with a complementary focus on heavy duty, industrial equipment and the original equipment market. We are organized into two major operating segments, each of which focuses on specific lines of replacement parts. Our Engine Management Segment manufactures and remanufactures ignition and emission parts, ignition wires, battery cables, fuel system parts and sensors for vehicle systems. Our Temperature Control Segment manufactures and remanufactures air conditioning compressors, air conditioning and heating parts, engine cooling system parts, power window accessories, and windshield washer system parts.

We sell our products primarily to large retail chains, warehouse distributors, original equipment manufacturers and original equipment service part operations in the United States, Canada, Latin America, and Europe. Our customers consist of many of the leading auto parts retail chains, such as NAPA Auto Parts (National Automotive Parts Association, Inc.), Advance Auto Parts, Inc./CARQUEST Auto Parts, AutoZone, Inc., O’Reilly Automotive, Inc., Canadian Tire Corporation Limited and The Pep Boys Manny, Moe & Jack, as well as national program distribution groups, such as Auto Value and All Pro/Bumper to Bumper (Aftermarket Auto Parts Alliance, Inc.), Automotive Distribution Network LLC, The National Pronto Association (“Pronto”), Federated Auto Parts Distributors, Inc. (“Federated”), Pronto and Federated’s affiliate, the Automotive Parts Services Group or The Group, Auto Plus and specialty market distributors. We distribute parts under our own brand names, such as Standard®, Blue Streak®, BWD®, Select®, Intermotor®, GP Sorensen®, TechSmart®, Tech Expert®, OEM®, LockSmart®, Four Seasons®, EVERCO®, ACi® and Hayden® and through co-labels and private labels, such as CARQUEST®, Duralast®, Duralast Gold®, Import Direct®, Master Pro®, Omni-Spark®, Ultima Select®, Murray®, NAPA® Echlin®, NAPA Proformer™ Mileage Plus®, NAPA Temp Products™, NAPA® Belden®, Cold Power®, Driveworks™ and ToughOne™.



## Index

Our goal is to grow revenues and earnings and deliver returns in excess of our cost of capital by being the best-in-class, full-line, full-service supplier of premium products to the engine management and temperature control markets. Our management places significant emphasis on improving our financial performance by achieving operating efficiencies and improving asset utilization, while maintaining product quality and high customer order fill rates. We intend to continue to improve our operating efficiency, customer satisfaction and cost position by increasing cost effective vertical integration in key product lines through internal development and improving our cost effectiveness and competitive responsiveness to better serve our customer base, including sourcing certain products from low cost regions such as those in Asia without compromising product quality.

**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, as we experienced in 2017, may lessen the demand for our Temperature Control products, while a warm summer, as we experienced in 2016, may increase such demand. As a result of this seasonality and variability in demand of our Temperature Control products, our working capital requirements typically 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.

**Inventory Management.** We face inventory management issues as a result of overstock returns. We permit our customers to return new, undamaged products to us within customer-specific limits (which are generally limited to a specified percentage of their annual purchases from us) in the event that they have overstocked their inventories. In addition, the seasonality of our Temperature Control Segment requires that we increase our inventory during the winter season in preparation of the summer selling season and customers purchasing such inventory have the right to make returns. We accrue for overstock returns as a percentage of sales, after giving consideration to recent returns history.

**Discounts, Allowances and Incentives.** We offer a variety of usual customer discounts, allowances and incentives. First, we offer cash discounts for paying invoices in accordance with the specified discount terms of the invoice. Second, we offer pricing discounts based on volume purchased from us and participation in our cost reduction initiatives. 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.

## Tax Cuts and Jobs Act

In December 2017, the U.S. enacted the Tax Cuts and Jobs Act (the “Act”), which included a broad range of tax reform affecting businesses, including the reduction of the federal corporate income tax rate from 35% to 21%, changes in the deductibility of certain business expenses, and the manner in which international operations are taxed in the U.S. Reflecting the impact of the Act on our income tax provision, the effective income tax rate for the three months and nine months ended September 30, 2018 was 26.6% and 26.1%, respectively, as compared to an effective income tax rate of 35.8% and 37.1% for the comparable periods of 2017, respectively.



Index

As related to the deemed repatriation of earnings of foreign subsidiaries, the Act includes a mandatory one-time tax on accumulated earnings of foreign subsidiaries. As a result, all previously unremitted earnings for which no U.S. deferred tax liability had been accrued are now subject to U.S. tax. In accordance with the guidelines provided in the Act, as of December 31, 2017 we have aggregated our estimated foreign earnings and profits, and utilized participating deductions and available foreign tax credits. The gross repatriation tax was \$2.3 million, which was offset by \$0.9 million of foreign tax credits for a net repatriation tax charge of \$1.4 million. The net repatriation tax of \$1.4 million was recorded in the fourth quarter of 2017. During the second and third quarters of 2018, we refined and updated our calculation of the gross repatriation tax to \$2.7 million, which was paid to the U.S. Treasury. The difference in the refined and updated repatriation tax and what was previously recorded in the fourth quarter of 2017 was reflected in the second and third quarter 2018 tax provisions. Notwithstanding the U.S. taxation of these amounts, we intend to continue to invest most or all of these earnings indefinitely outside of the U.S., and do not expect to incur any significant additional taxes related to such amounts.

## Interim Results of Operations:

## Comparison of the Three Months Ended September 30, 2018 to the Three Months Ended September 30, 2017

Sales. Consolidated net sales for the three months ended September 30, 2018 were \$296.6 million, an increase of \$15.5 million, or 5.5%, compared to \$281.1 million in the same period of 2017. Consolidated net sales increased due to the higher results achieved by both our Engine Management and Temperature Control Segments.

The following table summarizes consolidated net sales by segment and by major product group within each segment for the three months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,	
	2018	2017
Engine Management:		
Ignition, Emission and Fuel System Parts	\$ 159,101	\$ 155,544
Wire and Cable	38,469	41,232
Total Engine Management	197,570	196,776
Temperature Control:		
Compressors	54,842	44,733
Other Climate Control Parts	41,237	36,427
Total Temperature Control	96,079	81,160
All Other	2,970	3,122
Total	\$ 296,619	\$ 281,058

Engine Management's net sales increased \$0.8 million, or 0.4%, to \$197.6 million for the three months ended September 30, 2018. Net sales in the ignition, emissions and fuel systems parts product group for the three months ended September 30, 2018 were \$159.1 million, an increase of \$3.6 million, or 2.3%, compared to \$155.5 million in the same period of 2017. Net sales in the wire and cable product group for the three months ended September 30, 2018 were \$38.5 million, a decrease of \$2.7 million, or 6.7%, compared to \$41.2 million in the three months ended September 30, 2017. Engine Management's increase in net sales for the third quarter of 2018 compared to the same period in 2017 reflects the impact of increased demand for our products in ignition, emissions and fuel systems parts, as our customers experienced increases in product sell-through for these products. The year-over-year increase in our Engine Management ignition, emissions and fuel systems parts product group more than offset the decline in our wire and cable business, which is an older technology used on fewer cars, and due to the product lifecycle will continue to

reduce overall Engine Management net sales. Excluding the impact of the wire and cable business, our Engine Management customers have been reporting solid POS gains all year, which in the third quarter of 2018 were up in the mid-single digits over the third quarter of 2017.

30

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Index

Temperature Control's net sales increased \$14.9 million, or 18.4%, to \$96.1 million for the three months ended September 30, 2018. Net sales in the compressors product group for the three months ended September 30, 2018 were \$54.8 million, an increase of \$10.1 million, or 22.6%, compared to \$44.7 million in the same period of 2017. Net sales in the other climate control parts product group for the three months ended September 30, 2018 were \$41.2 million, an increase of \$4.8 million, or 13.2%, compared to \$36.4 million in the three months ended September 30, 2017. Temperature Control's increase in net sales for the third quarter of 2018 compared to the same period in 2017 reflects the impact of warming trends in summer weather conditions which began in mid-May. After a slow start to the 2018 season, reflecting the impact of a mild 2017 summer, higher than normal customer inventory levels going into 2018, and a cool early spring, customer orders strengthened in June and continued throughout the third quarter of 2018, resulting in strong third quarter 2018 Temperature Control sales. Demand for our Temperature Control products in the fourth quarter of 2018 will depend upon ongoing weather conditions and customer inventory levels.

Gross Margins. Gross margins, as a percentage of consolidated net sales, were 29.4% in both the third quarter of 2018 and 2017. The following table summarizes gross margins by segment for the three months ended September 30, 2018 and 2017, respectively (in thousands):

Three Months Ended September 30, <u>2018</u>	Engine Management	Temperature Control	Other	Total
Net sales	\$ 197,570	\$ 96,079	\$2,970	\$296,619
Gross margins	57,188	26,523	3,595	87,306
Gross margin percentage	28.9	% 27.6	% —	29.4 %
<u>2017</u>				
Net sales	\$ 196,776	\$ 81,160	\$3,122	\$281,058
Gross margins	57,808	21,721	3,006	82,535
Gross margin percentage	29.4	% 26.8	% —	29.4 %

Compared to the third quarter of 2017, gross margins at Engine Management decreased 0.5 percentage points from 29.4% to 28.9%, while gross margins at Temperature Control increased 0.8 percentage points from 26.8% to 27.6%. The gross margin percentage decrease in Engine Management compared to the prior year reflects the impact of product mix, and a year-over-year increase in inefficiencies and redundant costs incurred as a result of our various planned production moves. The year-over-year gross margin benefit in Temperature Control reflects the positive impact of higher production volumes and the fact that we are now essentially fully low cost in our manufacturing, having exited our Grapevine, Texas operations.

Selling, General and Administrative Expenses. Selling, general and administrative expenses ("SG&A") increased to \$60.1 million, or 20.3% of consolidated net sales, in the third quarter of 2018, as compared to \$55 million, or 19.6% of consolidated net sales, in the third quarter of 2017. The \$5.1 million increase in SG&A expenses as compared to the third quarter of 2017 is principally due to higher distribution expenses at Temperature Control and higher expenses related to the sale of receivables, offset in part, by lower selling and marketing expenses. The higher than usual distribution expenses at Temperature Control were due to a combination of significant additional labor costs to keep up with the surge in sales, as well as start-up costs related to the installation of a new automation project in our distribution center. We believe this project will be complete and fully optimized by year-end, and we will see substantial improvements next year.

Restructuring and Integration Expenses. Restructuring and integration expenses for the third quarter of 2018 were \$6,000 compared to restructuring and integration expenses of \$1.1 million for the third quarter of 2017. The \$1.1 million year-over-year decrease in restructuring and integration expenses reflects the impact of lower expenses incurred in connection with the plant rationalization program that commenced in February 2017, the wire and cable

relocation program announced in October 2017, and the Orlando plant rationalization program that commenced in January 2017, all of which were substantially completed as of September 30, 2018.

Index

Other Income, net. Other income, net was \$15,000 in the third quarter of 2018, compared to \$0.3 million in the third quarter of 2017. During the third quarter of 2017, we recognized a deferred gain of \$0.3 million related to the sale-leaseback of our Long Island City, New York facility. The recognition of the deferred gain related to the sale-leaseback of our Long Island City, New York facility ended in the first quarter of 2018 upon the termination of the initial 10-year lease term for the facility.

Operating Income. Operating income increased to \$27.2 million in the third quarter of 2018, compared to \$26.8 million in the third quarter of 2017. The year-over-year increase in operating income of \$0.4 million is the result of the impact of higher consolidated net sales and lower restructuring and integration expenses, which more than offset the impact of higher SG&A expenses.

Other Non-Operating Income, Net. Other non-operating income, net was \$0.4 million in the third quarter of 2018, compared to \$0.5 million in the third quarter of 2017. The slight year-over-year decline in other non-operating income, net resulted primarily from the unfavorable impact of changes in foreign currency exchange rates and the year-over-year decline in the actuarial net gain related to our postretirement medical benefit plans, which was offset, in part, by higher year-over-year equity income from our joint ventures. Our postretirement medical benefit plans to substantially all eligible U.S. and Canadian employees terminated on December 31, 2016.

Interest Expense. Interest expense increased to \$1.3 million in the third quarter of 2018, compared to \$0.6 million in the third quarter of 2017. The year-over-year increase in interest expense reflects the impact of both higher average outstanding borrowings in 2018 when compared to 2017, and higher year-over-year average interest rates on our revolving credit facility.

Income Tax Provision. The income tax provision in the third quarter of 2018 was \$7 million at an effective tax rate of 26.6% compared to \$9.5 million at an effective tax rate of 35.8% for the same period in 2017. The lower effective tax rate in the third quarter of 2018 compared to the third quarter of 2017 reflects the impact of the Tax Cuts and Jobs Act enacted in the U.S. in December 2017, which included a broad range of tax reform affecting businesses, including the reduction of the federal corporate tax rate from 35% to 21%, changes in the deductibility of certain business expenses, and the manner in which international operations are taxed in the U.S.

Loss from Discontinued Operations. Loss from discontinued operations, net of income tax, reflects information contained in the most recent actuarial studies performed as of August 31, 2018 and 2017, other information available and considered by us, and legal expenses associated with our asbestos-related liability. During the third quarter of 2018 and 2017, we recorded a loss of \$3.5 million and \$4 million from discontinued operations, respectively. The loss from discontinued operations for the third quarter of 2018 and 2017 includes a \$3.5 million and \$6 million pre-tax provision, respectively, to increase our indemnity liability in line with the August 2018 and 2017 actuarial studies, as well as legal fees incurred in litigation. As discussed more fully in Note 16 in the notes to our consolidated financial statements (unaudited), we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

Index

Comparison of the Nine Months Ended September 30, 2018 to the Nine Months Ended September 30, 2017

Sales. Consolidated net sales for the nine months ended September 30, 2018 were \$845.1 million, a decrease of \$31.1 million, or 3.5%, compared to \$876.2 million in the same period of 2017. Consolidated net sales decreased in both our Engine Management and Temperature Control Segments.

The following table summarizes consolidated net sales by segment and by major product group within each segment for the nine months ended September 30, 2018 and 2017 (in thousands):

	Nine months ended September 30,	
	2018	2017
Engine Management:		
Ignition, Emission and Fuel System Parts	\$ 482,640	\$ 498,802
Wire and Cable	117,847	132,637
Total Engine Management	600,487	631,439
Temperature Control:		
Compressors	131,680	132,278
Other Climate Control Parts	105,000	106,563
Total Temperature Control	236,680	238,841
All Other	7,914	5,885
Total	\$ 845,081	\$ 876,165

Engine Management's net sales decreased \$30.9 million, or 4.9%, to \$600.5 million for the first nine months of 2018. Net sales in the ignition, emissions and fuel systems parts product group for the nine months ended September 30, 2018 were \$482.6 million, a decrease of \$16.2 million, or 3.2%, compared to \$498.8 million in the same period of 2017. Net sales in the wire and cable product group for the nine months ended September 30, 2018 were \$117.8 million, a decrease of \$14.8 million, or 11.2%, compared to \$132.6 million in the first nine months of 2017. Engine Management's decrease in net sales for the first nine months of 2018 compared to the same period in 2017 reflects the impact of large pipeline orders placed in the first half of 2017 by certain customers, who were in the process of increasing the breadth and depth of their inventories. In addition, Engine Management's year-over-year decrease in net sales reflects the impact of the gradual decline in our wire and cable business, which is an older technology used on fewer cars, and due to the product lifecycle will continue to reduce overall Engine Management net sales. During the third quarter of 2018, as our customers experienced increases in Engine Management product sell-through, demand for our products in ignition, emissions and fuel system parts increased, resulting in an increase in Engine Management sales in the third quarter of 2018 compared to the same period of 2017.

Temperature Control's net sales decreased \$2.1 million, or 0.9%, to \$236.7 million for the first nine months of 2018. Net sales in the compressors product group for the nine months ended September 30, 2018 were \$131.7 million, a decrease of \$0.6 million, or 0.5%, compared to \$132.3 million in the same period of 2017. Net sales in the other climate control parts product group for the nine months ended September 30, 2018 were \$105 million, a decrease of \$1.6 million, or 1.5%, compared to \$106.6 million in the first nine months of 2017. Temperature Control's decrease in net sales for the first nine months of 2018 compared to the same period in 2017 reflects the impact of a slow start to the 2018 season, resulting from a mild 2017 summer, higher than normal customer inventory levels going into 2018, and a cool early spring. As weather conditions began to turn warm in mid-May, customer orders strengthened in June and continued throughout the third quarter of 2018, resulting in strong third quarter 2018 Temperature Control sales. Demand for our Temperature Control products in the fourth quarter of 2018 will depend upon ongoing weather conditions and customer inventory levels.



Index

Gross Margins. Gross margins, as a percentage of consolidated net sales, decreased to 28.5% in the first nine months of 2018, compared to 29.4% during the same period in 2017. The following table summarizes gross margins by segment for the nine months ended September 30, 2018 and 2017 (in thousands):

Nine Months Ended September 30, <u>2018</u>	Engine Management	Temperature Control	Other	Total
Net sales	\$ 600,487	\$ 236,680	\$7,914	\$845,081
Gross margins	171,440	60,990	8,754	241,184
Gross margin percentage	28.6 %	25.8 %	—	28.5 %

2017

Net sales	\$ 631,439	\$ 238,841	\$5,885	\$876,165
Gross margins	187,531	62,539	7,241	257,311
Gross margin percentage	29.7 %	26.2 %	—	29.4 %

Compared to the first nine months of 2017, gross margins at Engine Management decreased 1.1 percentage points from 29.7% to 28.6%, and gross margins at Temperature Control decreased 0.4 percentage points from 26.2% to 25.8%. The gross margin percentage decrease in Engine Management compared to the prior year reflects the impact of product mix, and a year-over year increase in inefficiencies and redundant costs incurred as a result of our various planned production moves. The gross margin percentage decrease in Temperature Control compared to the prior year resulted primarily from lower production volumes in the first half of 2018 following a mild 2017 summer season.

Selling, General and Administrative Expenses. SG&A expenses increased to \$175.6 million, or 20.8% of consolidated net sales, in the nine months ended September 30, 2018, as compared to \$172.7 million, or 19.7% of consolidated net sales, in the same period of 2017. The \$2.9 million increase in SG&A expenses as compared to the first nine months of 2017 is principally due to higher distribution expenses at Temperature Control and higher expenses related to the sale of receivables, offset in part, by lower selling and marketing expenses. The higher than usual distribution expenses at Temperature Control were due to a combination of significant additional labor costs to keep up with the surge in sales, as well as start-up costs related to the installation of a new automation project in our distribution center. We believe this project will be complete and fully optimized by year-end, and we will see substantial improvements next year.

Restructuring and Integration Expenses. Restructuring and integration expenses for the nine months ended September 30, 2018 were \$3.1 million compared to restructuring and integration expenses of \$3.9 million in the same period of 2017. The \$0.8 million year-over-year decrease in restructuring and integration expenses reflects the impact of lower expenses incurred in connection with the plant rationalization program that commenced in February 2017, the wire and cable relocation program announced in October 2017, and the Orlando plant rationalization program that commenced in January 2017, all of which were substantially completed as of September 30, 2018.

Other Income, Net. Other income, net was \$0.3 million and \$0.9 million in the nine months ended September 30, 2018 and 2017, respectively. During 2018 and 2017, we recognized \$0.2 million and \$0.8 million, respectively, of deferred gain related to the sale-leaseback of our Long Island City, New York facility. The recognition of the deferred gain related to the sale-leaseback of our Long Island City, New York facility ended in the first quarter of 2018 upon the termination of the initial 10-year lease term for the facility.

Operating Income. Operating income was \$62.8 million in the first nine months of 2018, compared to \$81.6 million for the same period in 2017. The year-over year decrease in operating income of \$18.8 million is the result of the impact of lower consolidated net sales, lower gross margins as a percentage of consolidated net sales and higher SG&A expenses, which more than offset the impact of lower restructuring and integration expenses.



## Index

**Other Non-Operating Income, Net.** Other non-operating income, net was \$0.8 million in the first nine months of 2018, compared to other non-operating income, net of \$2.4 million in the first nine months of 2017. The year-over-year decline in other non-operating income, net resulted primarily from lower year-over-year equity income from our joint ventures, the unfavorable impact of changes in foreign currency exchange rates, and the year-over-year decline in the actuarial net gain related to our postretirement medical benefit plans. Our postretirement medical benefit plans to substantially all eligible U.S. and Canadian employees terminated on December 31, 2016.

**Interest Expense.** Interest expense increased to \$3.1 million in the first nine months of 2018, compared to \$1.8 million for the same period in 2017. The year-over-year increase in interest expense reflects the impact of both higher average outstanding borrowings during the first nine months of 2018 when compared to the same period in 2017, and the higher year-over-year average interest rates on our revolving credit facility.

**Income Tax Provision.** The income tax provision for the nine months ended September 30, 2018 was \$15.8 million at an effective tax rate of 26.1%, compared to \$30.5 million at an effective tax rate of 37.1% for the same period in 2017. The lower effective tax rate in the first nine months of 2018 compared to the first nine months of 2017 reflects the impact of the Tax Cuts and Jobs Act enacted in the U.S. in December 2017, which included a broad range of tax reform affecting businesses, including the reduction of the federal corporate tax rate from 35% to 21%, changes in the deductibility of certain business expenses, and the manner in which international operations are taxed in the U.S.

**Loss from Discontinued Operations.** Loss from discontinued operations, net of income tax, reflects information contained in the most recent actuarial studies performed as of August 31, 2018 and 2017, other information available and considered by us, and legal expenses associated with our asbestos-related liability. During the nine months ended September 30, 2018 and 2017, we recorded a loss of \$5 million and \$5.1 million from discontinued operations, respectively. The loss from discontinued operations for the first nine months of 2018 and 2017 includes a \$3.5 million and \$6 million pre-tax provision, respectively, to increase our indemnity liability in line with the August 2018 and 2017 actuarial studies, as well as legal fees incurred in litigation. As discussed more fully in Note 16 in the notes to our consolidated financial statements (unaudited), we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

## Restructuring and Integration Programs

As of September 30, 2018, the plant rationalization program that commenced in February 2016, the wire and cable relocation program announced in October 2016, and the Orlando plant rationalization program that commenced in January 2017 are all substantially completed.

For a detailed discussion on the restructuring and integration costs, see Note 5, "Restructuring and Integration Expenses," of the notes to our consolidated financial statements (unaudited).

## Liquidity and Capital Resources

**Operating Activities.** During the first nine months of 2018, cash provided by operating activities was \$67.6 million compared to cash provided by operating activities of \$36.8 million in the same period of 2017. The year-over-year increase in operating cash flow is primarily the result of the smaller year-over-year increase in accounts receivable, the year-over-year decrease in inventories compared to the year-over-year increase in inventories in 2017, the larger year-over-year increase in accounts payable, the larger year-over-year increase in sundry payables and accrued expenses, and the year-over-year decrease in prepaid expenses and other current assets compared to the year-over-year increase in prepaid expenses and other current assets in 2017 offset, in part, by the decrease in net earnings.

Index

Net earnings during the first nine months of 2018 were \$39.7 million compared to \$46.6 million in the first nine months of 2017. During the first nine months of 2018, (1) the increase in receivables was \$23.4 million compared to the year-over-year increase in receivables of \$27.8 million in 2017; (2) the decrease in inventories was \$2.8 million compared to the year-over-year increase in inventories of \$18.7 million in 2017; (3) the decrease in prepaid expenses and other current assets was \$1.2 million compared to the year-over-year increase in prepaid expenses and other current assets of \$4.8 million in 2017; (4) the increase in accounts payable was \$5.2 million compared to the year-over-year increase in accounts payable of \$0.1 million in 2017; and (5) the increase in sundry payables and accrued expenses was \$12.8 million compared to the year-over-year increase in sundry payables and accrued expenses of \$8.7 million in 2017. We continue to actively manage our working capital to maximize our operating cash flow.

**Investing Activities.** Cash used in investing activities was \$25.4 million in the first nine months of 2018, compared to \$17.7 million in the same period of 2017. Investing activities during the first nine months of 2018 consisted of (1) the payment of the third and final contribution of \$5.7 million for our November 2017 acquisition of a 50% interest in Foshan FGD SMP Automotive Compressor Co., Ltd., a China-based joint venture that manufactures air conditioning compressors for the automotive aftermarket and the Chinese OE market; (2) the payment of \$4.2 million for our 15% increase in equity ownership in Foshan GWO YNG SMP Vehicle Climate Control & Cooling Products Co. Ltd., a China-based joint venture that manufactures air conditioner accumulators, filter driers, hose assemblies and switches for the automotive aftermarket and OEM/OES markets; and (3) capital expenditures of \$15.6 million. Investing activities during the first nine months of 2017 consisted of capital expenditures of \$17.7 million.

**Financing Activities.** Cash used in financing activities was \$32.6 million in the first nine months of 2018 as compared to \$14.2 million in the same period of 2017. During the first nine months of 2018, (1) we reduced our borrowings under our revolving credit facility by \$12 million as compared to the increase in borrowings under our revolving credit facility of \$18.2 million in 2017; (2) we made cash payments in the first nine months of 2018 for the repurchase of shares of our common stock of \$9.3 million as compared to \$20 million in 2017; and (3) we paid dividends of \$14.1 million in the first nine months of 2018 as compared to \$13 million in the comparable period last year. In February 2018, our Board of Directors voted to increase our quarterly dividend from \$0.19 per share in 2017 to \$0.21 per share in 2018.

In October 2015, we entered into a Credit Agreement with JPMorgan Chase Bank, N.A., as agent, and a syndicate of lenders for a senior secured revolving credit facility with a line of credit of up to \$250 million (with an additional \$50 million accordion feature) and a maturity date in October 2020. The line of credit under the agreement also allows for a \$10 million line of credit to Canada as part of the \$250 million available for borrowing. Direct borrowings under the credit agreement bear interest at LIBOR plus a margin ranging from 1.25% to 1.75% based on our borrowing availability, or floating at the alternate base rate plus a margin ranging from 0.25% to 0.75% based on our borrowing availability, at our option. The credit agreement is guaranteed by certain of our subsidiaries and secured by certain of our assets.

Borrowings under the credit agreement are secured by substantially all of our assets, including accounts receivable, inventory and certain fixed assets, and those of certain of our subsidiaries. Availability under the credit agreement is based on a formula of eligible accounts receivable, eligible inventory, eligible equipment and eligible fixed assets. After taking into account outstanding borrowings under the credit agreement, there was an additional \$201.8 million available for us to borrow pursuant to the formula at September 30, 2018. Outstanding borrowings under the credit agreement, which are classified as current liabilities, were \$45 million and \$57 million at September 30, 2018 and December 31, 2017, respectively. Borrowings under the restated credit agreement have been classified as current liabilities based upon the accounting rules and certain provisions in the agreement.

At September 30, 2018, the weighted average interest rate on our credit agreement was 3.4%, which consisted of \$45 million in direct borrowings. At December 31, 2017, the weighted average interest rate on our credit agreement was 2.7%, which consisted of \$57 million in direct borrowings. During the nine months ended September 30, 2018, our

average daily alternative base rate loan balance was \$2 million, compared to a balance of \$4.6 million for the nine months ended September 30, 2017, and a balance of \$3.8 million for the year ended December 31, 2017.

## Index

At any time that our borrowing availability is less than the greater of either (a) \$25 million, or 10% of the commitments if fixed assets are not included in the borrowing base, or (b) \$31.25 million, or 12.5% of the commitments if fixed assets are included in the borrowing base, the terms of the credit agreement provide for, among other provisions, a financial covenant requiring us, on a consolidated basis, to maintain a fixed charge coverage ratio of 1:1 at the end of each fiscal quarter (rolling four quarters). As of September 30, 2018, we were not subject to these covenants. The credit agreement permits us to pay cash dividends of \$20 million and make stock repurchases of \$20 million in any fiscal year subject to a minimum availability of \$25 million. Provided specific conditions are met, the credit agreement also permits acquisitions, permissible debt financing, capital expenditures, and cash dividend payments and stock repurchases of greater than \$20 million.

In December 2017, our Polish subsidiary, SMP Poland sp. z.o.o., entered into an overdraft facility with HSBC Bank Polska S.A. ("HSBC Poland") for Zloty 30 million (approximately \$8 million). The facility expires in December 2018. Borrowings under the overdraft facility will bear interest at a rate equal to WIBOR + 0.75% and are guaranteed by Standard Motor Products, Inc., the ultimate parent company. At September 30, 2018, borrowings under the overdraft facility were Zloty 21.7 million (approximately \$5.9 million).

In order to reduce our accounts receivable balances and improve our cash flow, we sell undivided interests in certain of our receivables to financial institutions. We enter these agreements at our discretion when we determine that the cost of factoring is less than the cost of servicing our receivables with existing debt. Under the terms of the agreements, we retain no rights or interest, have no obligations with respect to the sold receivables, and do not service the receivables after the sale. As such, these transactions are being accounted for as a sale.

Pursuant to these agreements, we sold \$224.4 million and \$566 million of receivables during the three months and nine months ended September 30, 2018, respectively, and \$210.6 million and \$614.6 million for the comparable periods in 2017. A charge in the amount of \$7.3 million and \$19 million related to the sale of receivables is included in selling, general and administrative expense in our consolidated statements of operations for the three months and nine months ended September 30, 2018, respectively, and \$6 million and \$17.6 million for the comparable periods in 2017. If we do not enter into these arrangements or if any of the financial institutions with which we enter into these arrangements were to experience financial difficulties or otherwise terminate these arrangements, our financial condition, results of operations and cash flows could be materially and adversely affected by delays or failures to collect future trade accounts receivable.

During 2017, our Board of Directors authorized the purchase of up to \$30 million of our common stock under stock repurchase programs. Under these programs, during the year ended December 31, 2017 and the nine months ended September 30, 2018, we repurchased 539,760 and 112,307 shares of our common stock, respectively, in the open market, at a total cost of \$24.8 million and \$5.2 million, respectively, thereby completing the 2017 Board of Directors' authorizations.

In May 2018, our Board of Directors authorized the purchase of up to an additional \$20 million of our common stock under a new stock repurchase program. Stock will be purchased from time to time, in the open market or through private transactions, as market conditions warrant. Under this program, during the three months and nine months ended September 30, 2018, we repurchased 37,011 and 82,975 shares of our common stock, respectively, at a total cost of \$1.8 million and \$3.9 million, respectively. As of September 30, 2018, there was approximately \$16.1 million available for future stock repurchases under the program. During the period from October 1, 2018 through October 26, 2018, we repurchased an additional 118,509 shares of our common stock under the program at a total cost of \$5.4 million, thereby reducing the amount available for future stock repurchases under the 2018 Board of Directors authorization to \$10.7 million.

Index

We anticipate that our cash flow from operations, available cash and available borrowings under our revolving credit facility will be adequate to meet our future liquidity needs for at least the next twelve months. Significant assumptions underlie this belief, including, among other things, that there will be no material adverse developments in our business, liquidity or capital requirements. If material adverse developments were to occur in any of these areas, there can be no assurance that our business will generate sufficient cash flow from operations, or that future borrowings will be available to us under our revolving credit facility in amounts sufficient to enable us to pay the principal and interest on our indebtedness, or to fund our other liquidity needs. In addition, if we default on any of our indebtedness, or breach any financial covenant in our revolving credit facility, our business could be adversely affected. For further information regarding the risks of our business, please refer to the Risk Factors section of our Annual Report on Form 10-K for the year ending December 31, 2017.

The following table summarizes our contractual commitments as of September 30, 2018 and expiration dates of commitments through 2028 (a) (b):

(In thousands)	2018	2019	2020	2021	2022	2023-2028	Total
Lease obligations	\$2,371	\$8,078	\$6,990	\$6,355	\$5,364	\$3,932	\$33,090
Postretirement benefits	104	39	36	32	29	107	347
Severance payments related to restructuring and integration	112	428	194	71	7	—	812
Total commitments	\$2,587	\$8,545	\$7,220	\$6,458	\$5,400	\$4,039	\$34,249

Indebtedness under our revolving credit facilities is not included in the table above as it is reported as a current (a) liability in our consolidated balance sheets. As of September 30, 2018, amounts outstanding under our revolving credit facilities were \$45 million.

We anticipate total aggregate future severance payments of approximately \$0.8 million related to the plant (b) rationalization program, the wire and cable relocation program and the Orlando plant rationalization program. All programs are substantially completed as of September 30, 2018.

### 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. There have been no material changes to our critical accounting policies and estimates from the information provided in Note 1 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017, except for changes made as a result of the adoption of the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers, described under the heading, “Recently Issued Accounting Pronouncements” in Note 2 and in Note 3, “Net Sales,” of the notes to our consolidated financial statements (unaudited).

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, the 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 assurances that actual results will not differ from those estimates. Although we do not believe that there is a reasonable likelihood that there will be a material change in the future estimate or in the assumptions that we use in calculating the estimate, unforeseen changes in the industry, or business could materially impact the estimate and may have a material adverse effect on our business, financial condition and results of operations.

Revenue Recognition. We derive our revenue primarily from sales of replacement parts for motor vehicles from both our Engine Management and Temperature Control Segments. The amount of consideration we receive and revenue we recognize depends on the marketing incentives, product warranty and overstock returns we offer to our customers. For certain 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 at the time of the sale but rather carried as a core liability. At the same time, we estimate the core expected to be returned from the customer and record the estimated return as unreturned customer inventory. The liability is extinguished when a core is actually returned to us, or at period end when we estimate and recognize revenue for core deposits not expected to be returned. 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.

Index

Inventory Valuation. Inventories are valued at the lower of cost and net realizable value. Cost is determined on the first-in, first-out basis. Where appropriate, standard cost systems are utilized for purposes of determining cost; the standards are adjusted as necessary to ensure they approximate actual costs. Estimates of lower of cost and net realizable value of inventory are determined by comparing the actual cost of the product to the estimated selling prices in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation of the inventory.

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. Future projected demand requires management judgment and is based upon (a) our review of historical trends and (b) our estimate of projected customer specific buying patterns and trends in the industry and markets in which we do business. Using rolling twelve month historical information, we estimate future demand on a continuous basis. As such, the historical volatility of such estimates has been minimal.

We utilize cores (used parts) in our remanufacturing processes for air conditioning compressors, diesel injectors, and diesel pumps. The production of air conditioning compressors, diesel injectors, and diesel pumps 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, at the time of sale of air conditioning compressors, diesel injectors, and diesel pumps, we estimate the core expected to be returned from the customer and record the estimated return as unreturned customer inventory.

In addition, many of our customers can return inventory to us based upon customer warranty and overstock arrangements within customer specific limits. At the time products are sold, we accrue a liability for product warranties and overstock returns and record as unreturned customer inventory our estimate of anticipated customer returns. Estimates are based upon historical information on the nature, frequency and probability of the customer return. Unreturned core, warranty and overstock customer inventory is recorded at standard cost. Revision to these estimates is made when necessary, based upon changes in these factors. We regularly study trends of such claims.

Sales Returns and Other Allowances and Allowance for Doubtful Accounts. 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 and/or the result of installation error. In addition to warranty returns, we also permit our customers to return new, undamaged 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. At the time products are sold, we accrue a liability for product warranties and overstock returns as a percentage of sales based upon estimates established using historical information on the nature, frequency and average cost of the claim and the probability of the customer return. At the same time, we record an estimate of anticipated customer returns as unreturned customer inventory. Significant judgments and estimates must be made and used in connection with establishing the sales returns and other allowances in any accounting period. Revision to these estimates is made when necessary, based upon changes in these factors. We regularly study trends of such claims. At September 30, 2018, the allowance for sales returns was \$53.7 million.

Similarly, we must make estimates of the uncollectability of our accounts receivable. We specifically analyze accounts receivable and analyze 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 September 30, 2018, the allowance for doubtful accounts and for discounts was \$5.5 million.

Index

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

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

We maintain valuation allowances when it is more likely than not that all or a portion of a deferred asset will not be realized. In determining whether a valuation allowance is warranted, we evaluate factors such as prior earnings history, expected future earnings, carryback and carryforward periods and tax strategies. We consider all positive and negative evidence to estimate if sufficient future taxable income will be generated to realize the deferred tax asset. We consider cumulative losses in recent years as well as the impact of one-time events in assessing our pre-tax earnings. Assumptions regarding future taxable income require significant judgment. Our assumptions are consistent with estimates and plans used to manage our business which includes restructuring and integration initiatives that are expected to generate significant savings in future periods.

The valuation allowance of \$0.4 million as of September 30, 2018 is intended to provide for the uncertainty regarding the ultimate realization of our U.S. foreign tax credit carryovers and foreign net operating loss carryovers. The assessment of the adequacy of our valuation allowance is based on our estimates of taxable income in these jurisdictions 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 the valuation allowance which could materially impact our business, financial condition and results of operations.

In accordance with generally accepted accounting practices, we recognize in our financial statements only those tax positions that meet the more-likely-than-not-recognition threshold. We establish tax reserves for uncertain tax positions that do not meet this threshold. As of September 30, 2018, we do not believe there is a need to establish a liability for uncertain tax positions. Penalties and interest associated with income tax matters are included in the provision for income taxes in our consolidated statement of operations.

**Valuation of Long Lived and Intangible Assets and Goodwill.** At acquisition, we estimate and record the fair value of purchased intangible assets, which primarily consists of customer relationships, trademarks and trade names, patents and non-compete agreements. The fair values of these intangible assets are estimated based on our assessment. Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. Goodwill and certain other intangible assets having indefinite lives are not amortized to earnings, but instead are subject to periodic testing for impairment. Intangible assets determined to have definite lives are amortized over their remaining useful lives.

## Index

We assess the impairment of long lived assets, identifiable intangibles assets and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. With respect to goodwill and identifiable intangible assets having indefinite lives, we test for impairment on an annual basis or in interim periods if an event occurs or circumstances change that may indicate the fair value is below its carrying amount. 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. We review the fair values using the discounted cash flows method and market multiples.

When performing our evaluation of goodwill for impairment, if we conclude qualitatively that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, than the two-step impairment test is not required. If we are unable to reach this conclusion, then we would perform the two-step impairment test. Initially, the fair value of the reporting unit is compared to its carrying amount. To the extent the carrying amount of a reporting unit exceeds the fair value of the reporting unit; we are required to perform a second step, as this is an indication that the reporting unit goodwill may be impaired. In this step, we compare the implied fair value of the reporting unit goodwill with the carrying amount of the reporting unit goodwill and recognize a charge for impairment to the extent the carrying value exceeds the implied fair value. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit to all of the assets (recognized and unrecognized) and liabilities of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. In addition, identifiable intangible assets having indefinite lives are reviewed for impairment on an annual basis using a methodology consistent with that used to evaluate goodwill.

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

There are inherent assumptions and estimates used in developing future cash flows requiring our judgment in applying these assumptions and estimates to the analysis of identifiable intangibles and long lived asset impairment including projecting revenues, interest rates, tax rates and the cost of capital. Many of the factors used in assessing fair value are outside our control and it is reasonably likely that assumptions and estimates will change in future periods. These changes can result in future impairments. 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.

Postretirement Medical Benefits. Each year, we calculate the costs of providing retiree benefits under the provisions of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 712, Nonretirement Postemployment Benefits. The determination of postretirement plan obligations and their associated costs requires the use of actuarial computations to estimate participant plan benefits the employees will be entitled to. The key assumptions used in making these calculations are the eligibility criteria of participants and the discount rate used to value the future obligation. The discount rate reflects the yields available on high-quality, fixed-rate debt securities.

Share-Based Compensation. The provisions of FASB ASC 718, Stock Compensation, require the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values on the grant date. The value of the portion of the award that is ultimately expected to vest is recognized as expense on a straight-line basis over the requisite service periods in our consolidated statement of operations. Forfeitures are estimated at the time of grant based on historical trends in order to estimate the amount of share-based awards that will ultimately vest. We monitor actual forfeitures for any subsequent adjustment to

forfeiture rates.

41

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Index

**Environmental Reserves.** We are subject to various U.S. Federal, state and local environmental laws and regulations and are involved in certain environmental remediation efforts. We estimate and accrue our liabilities resulting from such matters based upon a variety of factors including the assessments of environmental engineers and consultants who provide estimates of potential liabilities and remediation costs. Such estimates are not discounted to reflect the time value of money due to the uncertainty in estimating the timing of the expenditures, which may extend over several years. Potential recoveries from insurers or other third parties of environmental remediation liabilities are recognized independently from the recorded liability, and any asset related to the recovery will be recognized only when the realization of the claim for recovery is deemed probable.

**Asbestos Litigation.** We are responsible for certain future liabilities relating to alleged exposure to asbestos-containing products. In accordance with our accounting policy, our most recent actuarial study as of August 31, 2018 estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$37.1 million to \$56.9 million for the period through 2061. Based on the information contained in the actuarial study and all other available information considered by us, we have concluded that no amount within the range of settlement payments was more likely than any other and, therefore, in assessing our asbestos liability we compare the low end of the range to our recorded liability to determine if an adjustment is required. Based upon the results of the August 31, 2018 actuarial study, in September 2018 we increased our asbestos liability to \$37.1 million, the low end of the range, and recorded an incremental pre-tax provision of \$3.5 million in earnings (loss) from discontinued operations in the accompanying statement of operations. In addition, according to the updated study, future legal costs, which are expensed as incurred and reported in earnings (loss) from discontinued operations in the accompanying statement of operations, are estimated to range from \$44.9 million to \$80.6 million for the period through 2061. We will continue to perform an annual actuarial analysis during the third quarter of each year for the foreseeable future. Based on this analysis and all other available information, we will continue to reassess the recorded liability and, if deemed necessary, record an adjustment to the reserve, which will be reflected as a loss or gain from discontinued operations.

**Other Loss Reserves.** We have other loss exposures, for such matters as legal claims and legal proceedings. Establishing loss reserves for these matters requires estimates, judgment of risk exposure, and ultimate liability. We record provisions when the liability is considered probable and reasonably estimable. Significant judgment is required in both the determination of probability and the determination as to whether an exposure can be reasonably estimated. As additional information becomes available, we reassess our potential liability related to these matters. Such revisions of the potential liabilities could have a material adverse effect on our business, financial condition or results of operations.

**Recently Issued Accounting Pronouncements**

For a detailed discussion on recently issued accounting pronouncements and their impact on our consolidated financial statements, see Note 2, "Summary of Significant Accounting Policies" of the notes to our consolidated financial statements (unaudited).

Index

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and Qualitative Disclosure 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. As of September 30, 2018, we do not have any derivative financial instruments.

Exchange Rate Risk

We have exchange rate exposure, primarily, with respect to the Canadian Dollar, the Euro, the British Pound, the Polish Zloty, the Mexican Peso, the Taiwan Dollar, the Chinese Yuan Renminbi and the Hong Kong Dollar. As of September 30, 2018 and December 31, 2017, 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 the exchange rates affecting the foreign currencies in which monetary assets and liabilities are denominated and does not take into account the incremental effect of such a change on our foreign currency denominated revenues.

Interest Rate Risk

We manage our exposure to interest rate risk through the proportion of fixed rate debt and variable rate debt in our debt portfolio. To manage a portion of our exposure to interest rate changes, we have in the past entered into interest rate swap agreements. We invest our excess cash in highly liquid short-term investments. Substantially all of our debt is variable rate debt as of September 30, 2018 and December 31, 2017.

In addition, from time to time, we sell undivided interests in certain of our receivables to financial institutions. We enter these agreements at our discretion when we determine that the cost of factoring is less than the cost of servicing our receivables with existing debt. During the three months and nine months ended September 30, 2018, we sold \$224.4 million and \$566 million of receivables, respectively. Depending upon the level of sales of receivables pursuant these agreements, the effect of a hypothetical, instantaneous and unfavorable change of 100 basis points in the margin rate may have an approximate \$2.2 million and \$5.7 million negative impact on our earnings or cash flows during the three months and nine months ended September 30, 2018, respectively. The charge related to the sale of receivables is included in selling, general and administrative expenses in our consolidated statements of operations.

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, 2017.

Index

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

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

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

(b) Changes in Internal Control Over Financial Reporting.

During the quarter ended September 30, 2018, 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 review, document and test our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in the 2013 Internal Control – Integrated Framework. We may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business. These efforts may lead to various changes in our internal control over financial reporting.

Index

## PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this Item is incorporated herein by reference to the information set forth in Item 1, “Consolidated Financial Statements” of this Report under the captions “Asbestos” and “Other Litigation” appearing in Note 16, “Commitments and Contingencies,” of the notes to our consolidated financial statements (unaudited).

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information relating to the Company’s purchases of its common stock for the third quarter of 2018:

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Dollar Value) of Shares that may yet be Purchased Under the Plans or Programs (2)
July 1 – 31, 2018	19,390	\$ 47.96	19,390	\$ 16,966,810
August 1 – 31, 2018	9,821	48.21	9,821	16,493,333
September 1–30, 2018	7,800	49.64	7,800	16,106,139
Total	37,011	\$ 48.38	37,011	\$ 16,106,139

(1) All shares were purchased through the publicly announced stock repurchase programs in open-market transactions.

During 2017, our Board of Directors authorized the purchase of up to \$30 million of our common stock under stock repurchase programs. Under these programs, during the year ended December 31, 2017 and nine months (2) ended September 30, 2018, we repurchased 539,760 and 112,307 shares of our common stock, respectively, at a total cost of \$24.8 million and \$5.2 million, respectively, thereby completing the 2017 Board of Directors’ authorizations.

In May 2018, our Board of Directors authorized the purchase of up to an additional \$20 million of our common stock under a new stock repurchase program. Stock will be purchased from time to time, in the open market or through private transactions, as market conditions warrant. Under this program, during the three months and nine months ended September 30, 2018, we repurchased 37,011 and 82,975 shares of our common stock, respectively, at a total cost of \$1.8 million and \$3.9 million, respectively. As of September 30, 2018, there was approximately \$16.1 million available for future stock purchases under the program. During the period from October 1, 2018 through October 26, 2018, we repurchased an additional 118,509 shares of our common stock under the program at a total cost of \$5.4 million, thereby reducing the amount available for future stock repurchases under the Board of Directors authorization to \$10.7 million.

Index

ITEM 6. EXHIBITS

Exhibit  
Number

- 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.
- 101.INS\*\* XBRL Instance Document
- 101.SCH\*\* XBRL Taxonomy Extension Schema Document
- 101.CAL\*\* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.LAB\*\* XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE\*\* XBRL Taxonomy Extension Presentation Linkbase Document
- 101.DEF\*\* XBRL Taxonomy Extension Definition Linkbase Document

\*\* In accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to the Original Filing shall be deemed to be “furnished” and not “filed.”

Index

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: October 30, 2018 /s/ James J. Burke

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

47

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