

STANDARD MOTOR PRODUCTS INC

Form 10-Q

August 01, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

or

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

Commission file number: 1-4743

Standard Motor Products, Inc.

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of incorporation or organization)

11-1362020

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

37-18 Northern Blvd., Long Island City, N.Y.

(Address of principal executive offices)

11101

(Zip Code)

(718) 392-0200

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files).

Yes ☐ No ☒

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

Large Accelerated Filer ☒

Accelerated Filer ☐

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Non-Accelerated Filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

Yes ☐ No ☒

As of the close of business on July 30, 2014, there were 22,885,832 outstanding shares of the registrant's Common Stock, par value \$2.00 per share.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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## PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTSSTANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

| (In thousands, except share and per share data)            | Three Months Ended              |            | Six Months Ended                |            |
|------------------------------------------------------------|---------------------------------|------------|---------------------------------|------------|
|                                                            | June 30,<br>2014<br>(Unaudited) | 2013       | June 30,<br>2014<br>(Unaudited) | 2013       |
| Net sales                                                  | \$272,540                       | \$270,126  | \$505,292                       | \$500,834  |
| Cost of sales                                              | 195,141                         | 192,330    | 359,983                         | 357,210    |
| Gross profit                                               | 77,399                          | 77,796     | 145,309                         | 143,624    |
| Selling, general and administrative expenses               | 48,847                          | 50,588     | 96,441                          | 100,198    |
| Litigation charge                                          | 10,650                          | —          | 10,650                          | —          |
| Restructuring and integration expenses                     | 555                             | 200        | 726                             | 618        |
| Other income, net                                          | 273                             | 212        | 533                             | 442        |
| Operating income                                           | 17,620                          | 27,220     | 38,025                          | 43,250     |
| Other non-operating income (expense), net                  | 307                             | (64)       | (106)                           | (260)      |
| Interest expense                                           | 457                             | 646        | 765                             | 1,218      |
| Earnings from continuing operations before taxes           | 17,470                          | 26,510     | 37,154                          | 41,772     |
| Provision for income taxes                                 | 6,301                           | 10,110     | 13,578                          | 15,806     |
| Earnings from continuing operations                        | 11,169                          | 16,400     | 23,576                          | 25,966     |
| Loss from discontinued operations, net of income taxes     | (529)                           | (357)      | (1,211)                         | (749)      |
| Net earnings                                               | \$10,640                        | \$16,043   | \$22,365                        | \$25,217   |
| Per Share Data:                                            |                                 |            |                                 |            |
| Net earnings per common share – Basic:                     |                                 |            |                                 |            |
| Earnings from continuing operations                        | \$0.49                          | \$0.71     | \$1.03                          | \$1.13     |
| Discontinued operations                                    | (0.02)                          | (0.01)     | (0.05)                          | (0.03)     |
| Net earnings per common share – Basic                      | \$0.47                          | \$0.70     | \$0.98                          | \$1.10     |
| Net earnings per common share – Diluted:                   |                                 |            |                                 |            |
| Earnings from continuing operations                        | \$0.48                          | \$0.71     | \$1.02                          | \$1.12     |
| Discontinued operations                                    | (0.02)                          | (0.02)     | (0.06)                          | (0.03)     |
| Net earnings per common share – Diluted                    | \$0.46                          | \$0.69     | \$0.96                          | \$1.09     |
| Dividend declared per share                                | \$0.13                          | \$0.11     | \$0.26                          | \$0.22     |
| Average number of common shares                            | 22,874,002                      | 22,981,337 | 22,910,419                      | 22,917,769 |
| Average number of common shares and dilutive common shares | 23,196,713                      | 23,261,118 | 23,219,055                      | 23,190,091 |

See accompanying notes to consolidated financial statements.

IndexSTANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In thousands)                                                 | Three Months<br>Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|----------------------------------------------------------------|-----------------------------------|----------|------------------------------|----------|
|                                                                | 2014                              | 2013     | 2014                         | 2013     |
|                                                                | (Unaudited)                       |          | (Unaudited)                  |          |
| Net earnings                                                   | \$10,640                          | \$16,043 | \$22,365                     | \$25,217 |
| Other comprehensive income (loss), net of tax:                 |                                   |          |                              |          |
| Foreign currency translation adjustments                       | (141 )                            | (940 )   | (731 )                       | (1,752 ) |
| Pension and postretirement plans:                              |                                   |          |                              |          |
| Amortization of:                                               |                                   |          |                              |          |
| Prior service benefit                                          | (755 )                            | (1,080 ) | (1,509 )                     | (2,160 ) |
| Unrecognized loss                                              | 546                               | 776      | 1,138                        | 1,561    |
| Unrecognized amounts                                           | 150                               | 154      | 150                          | 154      |
| Foreign currency exchange rate changes                         | (3 )                              | (15 )    | (25 )                        | (27 )    |
| Income tax benefit related to pension and postretirement plans | 17                                | 51       | 75                           | 159      |
| Pension and postretirement plans, net of tax                   | (45 )                             | (114 )   | (171 )                       | (313 )   |
| Total other comprehensive income (loss), net of tax            | (186 )                            | (1,054 ) | (902 )                       | (2,065 ) |
| Comprehensive income                                           | \$10,454                          | \$14,989 | \$21,463                     | \$23,152 |

See accompanying notes to consolidated financial statements.

IndexSTANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

|                                                                                                                                 | June 30,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|---------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-------------------------|
| (In thousands, except share and per share data)                                                                                 |                                 |                         |
| <b>ASSETS</b>                                                                                                                   |                                 |                         |
| <b>CURRENT ASSETS:</b>                                                                                                          |                                 |                         |
| Cash and cash equivalents                                                                                                       | \$ 6,217                        | \$5,559                 |
| Accounts receivable, less allowances for discounts and doubtful accounts of \$6,749 and \$6,969 for 2014 and 2013, respectively | 144,291                         | 125,201                 |
| Inventories, net                                                                                                                | 292,459                         | 269,447                 |
| Deferred income taxes                                                                                                           | 35,525                          | 35,633                  |
| Prepaid expenses and other current assets                                                                                       | 17,851                          | 10,237                  |
| Total current assets                                                                                                            | 496,343                         | 446,077                 |
| Property, plant and equipment, net                                                                                              | 64,724                          | 63,646                  |
| Goodwill                                                                                                                        | 55,173                          | 38,005                  |
| Other intangibles, net                                                                                                          | 37,147                          | 34,861                  |
| Deferred income taxes                                                                                                           | 10,734                          | 10,278                  |
| Other assets                                                                                                                    | 38,200                          | 22,656                  |
| Total assets                                                                                                                    | \$ 702,321                      | \$615,523               |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                     |                                 |                         |
| <b>CURRENT LIABILITIES:</b>                                                                                                     |                                 |                         |
| Notes payable                                                                                                                   | \$ 59,070                       | \$21,406                |
| Current portion of long-term debt                                                                                               | 24                              | 59                      |
| Accounts payable                                                                                                                | 90,112                          | 71,469                  |
| Sundry payables and accrued expenses                                                                                            | 51,714                          | 41,939                  |
| Accrued customer returns                                                                                                        | 40,669                          | 31,464                  |
| Accrued rebates                                                                                                                 | 33,441                          | 28,758                  |
| Payroll and commissions                                                                                                         | 18,821                          | 25,221                  |
| Total current liabilities                                                                                                       | 293,851                         | 220,316                 |
| Long-term debt                                                                                                                  | 8                               | 16                      |
| Other accrued liabilities                                                                                                       | 22,301                          | 21,840                  |
| Accrued asbestos liabilities                                                                                                    | 22,607                          | 23,919                  |
| Total liabilities                                                                                                               | 338,767                         | 266,091                 |
| 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                                                                                                  | 90,398                          | 87,563                  |
| Retained earnings                                                                                                               | 244,446                         | 228,036                 |
| Accumulated other comprehensive income                                                                                          | 884                             | 1,786                   |
| Treasury stock – at cost (1,054,804 shares and 981,004 shares in 2014 and 2013, respectively)                                   | (20,046 )                       | (15,825 )               |

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|                                            |            |            |
|--------------------------------------------|------------|------------|
| Total stockholders' equity                 | 363,554    | 349,432    |
| Total liabilities and stockholders' equity | \$ 702,321 | \$ 615,523 |

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands)                                                                                | Six Months Ended<br>June 30,<br>2014      2013<br>(Unaudited) |          |
|-----------------------------------------------------------------------------------------------|---------------------------------------------------------------|----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                  |                                                               |          |
| Net earnings                                                                                  | \$22,365                                                      | \$25,217 |
| Adjustments to reconcile net earnings to net cash provided by (used in) operating activities: |                                                               |          |
| Depreciation and amortization                                                                 | 8,440                                                         | 8,545    |
| Amortization of deferred financing cost                                                       | 350                                                           | 542      |
| Increase (decrease) to allowance for doubtful accounts                                        | (359 )                                                        | 498      |
| Increase to inventory reserves                                                                | 1,960                                                         | 3,059    |
| Amortization of deferred gain on sale of building                                             | (524 )                                                        | (524 )   |
| Equity (income) loss from joint ventures                                                      | (147 )                                                        | 26       |
| Employee Stock Ownership Plan allocation                                                      | 913                                                           | 2,188    |
| Stock-based compensation                                                                      | 2,397                                                         | 1,494    |
| Excess tax benefits related to exercise of employee stock grants                              | (152 )                                                        | (66 )    |
| (Increase) decrease in deferred income taxes                                                  | (273 )                                                        | 142      |
| Loss on discontinued operations, net of tax                                                   | 1,211                                                         | 749      |
| Change in assets and liabilities:                                                             |                                                               |          |
| Increase in accounts receivable                                                               | (16,149)                                                      | (53,723) |
| Increase in inventories                                                                       | (19,527)                                                      | (31,885) |
| Increase in prepaid expenses and other current assets                                         | (6,702 )                                                      | (1,501 ) |
| Increase in accounts payable                                                                  | 13,847                                                        | 16,550   |
| Increase in sundry payables and accrued expenses                                              | 13,526                                                        | 19,304   |
| Net change in other assets and liabilities                                                    | (3,558 )                                                      | (3,014 ) |
| Net cash provided by (used in) operating activities                                           | 17,618                                                        | (12,399) |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                  |                                                               |          |
| Acquisitions of and investments in businesses                                                 | (37,726)                                                      | (12,760) |
| Capital expenditures                                                                          | (6,379 )                                                      | (5,551 ) |
| Other investing activities                                                                    | 11                                                            | (596 )   |
| Net cash used in investing activities                                                         | (44,094)                                                      | (18,907) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                  |                                                               |          |
| Net borrowings under line-of-credit agreements                                                | 37,664                                                        | 27,881   |
| Principal payments of long-term debt and capital lease obligations                            | (44 )                                                         | (62 )    |
| Purchase of treasury stock                                                                    | (5,860 )                                                      | (1,151 ) |
| Increase in overdraft balances                                                                | 1,784                                                         | 11,324   |
| Payment of debt issuance costs                                                                | —                                                             | (1,261 ) |
| Proceeds from exercise of employee stock options                                              | 97                                                            | 142      |
| Excess tax benefits related to the exercise of employee stock grants                          | 152                                                           | 66       |
| Dividends paid                                                                                | (5,955 )                                                      | (5,037 ) |
| Net cash provided by financing activities                                                     | 27,838                                                        | 31,902   |
| Effect of exchange rate changes on cash                                                       | (704 )                                                        | (1,395 ) |
| Net increase (decrease) in cash and cash equivalents                                          | 658                                                           | (799 )   |
| CASH AND CASH EQUIVALENTS at beginning of period                                              | 5,559                                                         | 13,074   |
| CASH AND CASH EQUIVALENTS at end of period                                                    | \$6,217                                                       | \$12,275 |



Supplemental disclosure of cash flow information:

Cash paid during the period for:

|              |          |          |
|--------------|----------|----------|
| Interest     | \$370    | \$664    |
| Income taxes | \$18,516 | \$16,892 |

See accompanying notes to consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
Six Months Ended June 30, 2014  
(Unaudited)

|                                                   | Common<br>Stock | Capital<br>in<br>Excess<br>of<br>Par<br>Value | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total     |
|---------------------------------------------------|-----------------|-----------------------------------------------|----------------------|--------------------------------------------------------|-------------------|-----------|
| (In thousands)                                    |                 |                                               |                      |                                                        |                   |           |
| Balance at December 31, 2013                      | \$47,872        | \$87,563                                      | \$228,036            | \$ 1,786                                               | \$(15,825)        | \$349,432 |
| Net earnings                                      | —               | —                                             | 22,365               | —                                                      | —                 | 22,365    |
| Other comprehensive income (loss), net of tax     | —               | —                                             | —                    | (902 )                                                 | —                 | (902 )    |
| Cash dividends paid                               | —               | —                                             | (5,955 )             | —                                                      | —                 | (5,955 )  |
| Purchase of treasury stock                        | —               | —                                             | —                    | —                                                      | (5,860 )          | (5,860 )  |
| Stock-based compensation and related tax benefits | —               | 1,992                                         | —                    | —                                                      | 516               | 2,508     |
| Stock options exercised and related tax benefits  | —               | 17                                            | —                    | —                                                      | 123               | 140       |
| Employee Stock Ownership Plan                     | —               | 826                                           | —                    | —                                                      | 1,000             | 1,826     |
| Balance at June 30, 2014                          | \$47,872        | \$90,398                                      | \$244,446            | \$ 884                                                 | \$(20,046)        | \$363,554 |

See accompanying notes to consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation

Standard Motor Products, Inc. and subsidiaries (referred to hereinafter in these notes to consolidated financial statements as the “Company,” “we,” “us,” or “our”) is engaged in the manufacture and distribution of replacement parts for motor vehicles in the automotive aftermarket industry with an increasing focus on 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, 2013. The unaudited consolidated financial statements include our accounts and all domestic and international companies in which we have more than a 50% equity ownership. Our investments in unconsolidated affiliates are accounted for on the equity method, as we do not have a controlling financial interest. 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 2014 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, pensions and 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, 2013.

Recently Issued Accounting Pronouncements

Discontinued Operations and Disclosures of Disposals of Components of an Entity

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (“ASU 2014-08”), which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and “represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results.” The new standard applies prospectively to new disposals and new classifications of disposal groups as held for sale after the effective date. The amendment is effective for annual reporting periods beginning after December 15, 2014, which for us is January 1, 2015, and interim periods within those annual periods. The adoption of this standard will not change the manner in which we currently present discontinued operations in our consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. 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 new standard provides entities the option of using either a full retrospective or a modified approach to adopt the guidance. The new standard is effective for annual reporting periods beginning after December 15, 2016, which for us is January 1, 2017, and interim periods within those annual periods. Early adoption is not permitted. We are currently evaluating the impact, if any, this new standard will have on our consolidated financial statements and have not yet determined the method of adoption.

Note 3. Business Acquisitions and Investments

2014 Business Acquisitions and Investment

Pensacola Fuel Injection, Inc. and Annex Manufacturing Acquisitions

In January 2014, we acquired certain assets and assumed certain liabilities of Pensacola Fuel Injection Inc., a privately held company, for \$12.2 million in cash funded by our revolving credit facility. Pensacola Fuel Injection, Inc., located in Pensacola, Florida, remanufactures and distributes a wide range of diesel injectors, diesel pumps and turbochargers. Prior to the acquisition, we were the primary purchaser of products supplied by the company. We anticipate that the acquisition will be accretive to earnings, excluding one-time integration costs.

In April 2014, we acquired certain assets and assumed certain liabilities of Annex Manufacturing, a privately held company, for approximately \$11.5 million in cash funded by our revolving credit facility. Annex Manufacturing, located in Fort Worth, Texas, distributes a variety of temperature control products for the automotive aftermarket. Revenues generated from the acquired business were approximately \$22 million for the year ended December 31, 2013, of which approximately 40% of the volume was sold to us.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

The allocation of purchase price to assets acquired and liabilities assumed is based upon their fair values. The following table presents the allocation of purchase price to assets acquired and liabilities assumed (in thousands):

|                                          | Pensacola Fuel<br>Injection, Inc. | Annex<br>Manufacturing |
|------------------------------------------|-----------------------------------|------------------------|
| Purchase price:                          | \$ 12,225                         | \$ 11,500              |
| Assets acquired and liabilities assumed: |                                   |                        |
| Receivables                              | \$—                               | \$ 2,581               |
| Inventory                                | 2,815                             | 2,630                  |
| Property, plant and equipment, net       | 466                               | 128                    |
| Intangible assets                        | —                                 | 4,760                  |
| Goodwill                                 | 12,528                            | 4,567                  |
| Current liabilities                      | (3,584 )                          | (3,166)                |
| Net assets acquired                      | \$ 12,225                         | \$ 11,500              |

Goodwill related to the Pensacola Fuel Injection, Inc. and Annex Manufacturing acquisitions of \$12.5 million and \$4.6 million, respectively, was allocated to the Engine Management Segment and Temperature Control Segment, respectively, and is deductible for income tax purposes. The goodwill reflects business specific knowledge and the replacement cost of an assembled workforce, as well as the value of expected synergies.

Intangible assets acquired in the Annex Manufacturing acquisition consisted of customer relationships of \$4.7 million that will be amortized on a straight-line basis over the estimated useful life of 7 years and non-compete agreements of \$0.1 million that will be amortized on a straight-line basis over the estimated useful life of 5 years.

Revenues included in our consolidated statements of operations for the Annex Manufacturing acquisition from the date of acquisition through June 30, 2014 were \$2.6 million. Revenues from the Pensacola Fuel Injection, Inc. acquisition from the date of acquisition were not material.

Gwo Yng Enterprise Co., Ltd. Equity Investment

In April 2014, we formed a 50/50 joint venture with Gwo Yng Enterprise Co., Ltd., a China-based manufacturer of air conditioning 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 \$14 million in cash funded by our revolving credit facility. 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.

## 2013 Business Acquisition and Investment

Orange Electronic Equity Investment

In January 2013, we acquired an approximate 25% minority interest in Orange Electronic Co., Ltd. for \$6.3 million in cash funded by our revolving credit facility. Orange Electronic Co., Ltd. is a manufacturer of tire pressure monitoring system sensors and is located in Taiwan. Our minority interest in Orange Electronic Co., Ltd. is accounted for under the equity method of accounting.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

European OE Business Acquisition

In February 2013, we acquired the original equipment business of Standard Motor Products Holdings Ltd. (“SMP Europe”), our former affiliate in the U.K., for £4.2 million (\$6.5 million) in cash funded by our revolving credit facility. SMP Europe was a distributor of original equipment parts that were primarily manufactured in our Bialystok, Poland manufacturing facility.

Intangible assets acquired in the acquisition consisted of \$3.8 million of customer relationships that will be amortized on a straight-line basis over the estimated useful life of 10 years and goodwill of \$2 million. Goodwill related to the acquisition was allocated to the Engine Management Segment. The goodwill reflects business specific knowledge, replacement cost of an assembled workforce, as well as the value of expected synergies.

Revenues included in our consolidated statements of operations for the SMP Europe acquisition during the three months and six months ended June 30, 2014 were not material.

## Note 4. Restructuring and Integration Costs

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, 2013 and June 30, 2014 and activity for the six months ended June 30, 2014 consisted of the following (in thousands):

|                                              | Workforce<br>Reduction | Other<br>Exit<br>Costs | Total   |
|----------------------------------------------|------------------------|------------------------|---------|
| Exit activity liability at December 31, 2013 | \$ 2,800               | \$942                  | \$3,742 |
| Restructuring and integration costs:         |                        |                        |         |
| Amounts provided for during 2014             | 424                    | 302                    | 726     |
| Cash payments                                | (1,339 )               | (381)                  | (1,720) |
| Exit activity liability at June 30, 2014     | \$ 1,885               | \$863                  | \$2,748 |

Liabilities associated with the remaining restructuring and integration costs as of June 30, 2014 relate primarily to employee severance and other retiree benefit enhancements to be paid through 2017 and environmental clean-up costs at our Long Island City, New York location in connection with the closure of our manufacturing operations at the site.

## Note 5. 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 \$188.8 million and \$366.2 million of receivables during the three months and six months ended June 30, 2014, respectively, and \$183.9 million and \$334.3 million for the comparable periods in 2013. A charge in the amount of \$3.6 million and \$6.9 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 six months ended June 30, 2014, respectively, and \$3.9 million and \$7.1 million for the comparable periods in 2013. 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.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 6. Inventories, Net

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:

|                        | June 30,<br>2014<br>(In thousands) | December<br>31,<br>2013 |
|------------------------|------------------------------------|-------------------------|
| Finished goods, net    | \$199,053                          | \$181,735               |
| Work-in-process, net   | 5,223                              | 4,984                   |
| Raw materials, net     | 88,183                             | 82,728                  |
| Total inventories, net | \$292,459                          | \$269,447               |

## Note 7. Acquired Intangible Assets

Acquired identifiable intangible assets consist of the following:

|                                   | June 30,<br>2014<br>(In thousands) | December<br>31,<br>2013 |
|-----------------------------------|------------------------------------|-------------------------|
| Customer relationships            | \$49,017                           | \$44,179                |
| Trademarks and trade names        | 6,800                              | 6,800                   |
| Non-compete agreements            | 970                                | 910                     |
| Patents and supply contracts      | 723                                | 723                     |
| Leaseholds                        | 160                                | 160                     |
| Total acquired intangible assets  | 57,670                             | 52,772                  |
| Less accumulated amortization (1) | (21,612)                           | (19,202 )               |
| Net acquired intangible assets    | \$36,058                           | \$33,570                |

(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.

In April 2014, we acquired certain assets and assumed certain liabilities of Annex Manufacturing. Intangible assets acquired consisted of customer relationships of \$4.7 million that will be amortized on a straight-line basis over the estimated useful life of 7 years and non-compete agreements of \$0.1 million that will be amortized on a straight-line basis over the estimated useful life of 5 years.

Total amortization expense for acquired intangible assets was \$1.2 million and \$2.4 million for the three months and six months ended June 30, 2014, respectively, and \$1.4 million and \$2.7 million for the comparable periods in 2013. Based on the current estimated useful lives assigned to our acquired intangible assets, amortization expense is estimated to be \$2.6 million for the remainder of 2014, \$5 million in 2015, \$4.9 million in 2016, \$4.7 million in 2017 and \$13.7 million in the aggregate for the years 2018 through 2028.



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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 8. Credit Facilities and Long-Term Debt

Total debt outstanding is summarized as follows:

|                             | June 30,<br>2014 | December<br>31,<br>2013 |
|-----------------------------|------------------|-------------------------|
|                             | (In thousands)   |                         |
| Revolving credit facilities | \$59,070         | \$ 21,406               |
| Other                       | 32               | 75                      |
| Total debt                  | \$59,102         | \$ 21,481               |
|                             |                  |                         |
| Current maturities of debt  | \$59,094         | \$ 21,465               |
| Long-term debt              | 8                | 16                      |
| Total debt                  | \$59,102         | \$ 21,481               |

## Deferred Financing Costs

We had deferred financing costs of \$2.6 million and \$3 million as of June 30, 2014 and December 31, 2013, respectively. Deferred financing costs are related to our revolving credit facility. Deferred financing costs as of June 30, 2014 are being amortized in the amounts of \$0.3 million for the remainder of 2014, \$0.7 million in 2015, \$0.7 million in 2016, \$0.7 million in 2017 and \$0.2 million in 2018.

## Revolving Credit Facility

In November 2010, we entered into a Third Amended and Restated Credit Agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The restated credit agreement (as amended) provides for a line of credit of up to \$250 million (inclusive of the Canadian revolving credit facility described below) and expires in March 2018. Direct borrowings under the restated credit agreement bear interest at the LIBOR rate plus the applicable margin (as defined), or floating at the index rate plus the applicable margin, at our option. The interest rate may vary depending upon our borrowing availability. The restated credit agreement is guaranteed by certain of our subsidiaries and secured by certain of our assets.

In February 2013, we amended the restated credit agreement to provide us with greater flexibility regarding the payment of cash dividends and stock repurchases. In May 2013, we further amended our restated credit agreement (1) to extend the maturity date of our credit facility to March 2018; (2) to increase the line of credit from \$200 million to \$250 million (inclusive of the Canadian revolving credit facility described below); (3) to reduce the margin added to the LIBOR rate to 1.50% - 2%; (4) to reduce the margin added to the index rate to 0.50% - 1%; (5) to reduce the unused fee to 0.25%; and (6) to provide us with greater flexibility regarding acquisitions, other permissible debt financing, cash held and capital expenditures, among other matters.

Borrowings under the restated credit agreement are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. After taking into account outstanding borrowings under the restated credit agreement, there was an additional \$164 million available for us to borrow pursuant to the formula at June 30, 2014. Outstanding borrowings under the restated credit agreement (inclusive of

the Canadian revolving credit facility described below), which are classified as current liabilities, were \$59.1 million and \$21.4 million at June 30, 2014 and December 31, 2013, respectively. Borrowings under the restated credit agreement have been classified as current liabilities based upon the accounting rules and certain provisions in the agreement.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

At June 30, 2014, the weighted average interest rate on our restated credit agreement was 1.8%, which consisted of \$56 million in direct borrowings at 1.7% and an index loan of \$3.1 million at 3.8%. At December 31, 2013, the weighted average interest rate on our restated credit agreement was 2%, which consisted of \$18 million in direct borrowings at 1.7% and an index loan of \$3.4 million at 3.8%. During the six months ended June 30, 2014, our average daily index loan balance was \$4.5 million compared to \$4.9 million for the six months ended June 30, 2013 and \$4.1 million for the year ended December 31, 2013.

At any time that our average borrowing availability is less than \$25 million, the terms of our restated credit agreement provide for, among other provisions, a financial covenant requiring us, on a consolidated basis, to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months). As of June 30, 2014, we were not subject to these covenants. Availability under our restated credit agreement is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. Our restated credit agreement also permits dividends and distributions by us provided specific conditions are met.

Canadian Revolving Credit Facility

In May 2010, we amended our Canadian Credit Agreement with GE Canada Finance Holding Company, for itself and as agent for the lenders. The amended Canadian Credit Agreement provided for the conversion of the then existing \$10 million line of credit into a revolving credit facility. The Canadian \$10 million line of credit is part of the \$250 million available for borrowing under our restated credit agreement with General Electric Capital Corporation.

In May 2013, we further amended our Canadian Credit Agreement to extend the maturity date of the agreement to March 2018 and modify certain provisions, including interest rates, to parallel the revolving credit provisions of the restated credit agreement (described above). The amended credit agreement is guaranteed and secured by us and certain of our wholly-owned subsidiaries. Direct borrowings under the amended credit agreement bear interest at the same rate as our restated credit agreement with General Electric Capital Corporation. As of June 30, 2014, we have no outstanding borrowings under the Canadian Credit Agreement.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 9. Accumulated Other Comprehensive Income

## Changes in Accumulated Other Comprehensive Income by Component

|                                                                  | Three Months Ended June 30,<br>2014                                                                                |             |           |
|------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|-------------|-----------|
|                                                                  | Unrecognized<br>Foreign Pension and<br>Currency Postretirement<br>Translation Benefit Costs<br>Adjustment (Credit) |             | Total     |
| Beginning balance at March 31, 2014                              | \$2,972                                                                                                            | \$ (1,902 ) | ) \$1,070 |
| Other comprehensive income before reclassifications              | (141 )                                                                                                             | 147         | 6         |
| Amounts reclassified from accumulated other comprehensive income | —                                                                                                                  | (192 )      | ) (192 )  |
| Current period other comprehensive income, net                   | (141 )                                                                                                             | (45 )       | ) (186 )  |
| Ending balance at June 30, 2014                                  | \$2,831                                                                                                            | \$ (1,947 ) | ) \$884   |

|                                                                  | Six Months Ended June 30, 2014                                                                                     |             |           |
|------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------|-------------|-----------|
|                                                                  | Unrecognized<br>Foreign Pension and<br>Currency Postretirement<br>Translation Benefit Costs<br>Adjustment (Credit) |             | Total     |
| Beginning balance at December 31, 2013                           | \$3,562                                                                                                            | \$ (1,776 ) | ) \$1,786 |
| Other comprehensive income before reclassifications              | (731 )                                                                                                             | 125         | (606 )    |
| Amounts reclassified from accumulated other comprehensive income | —                                                                                                                  | (296 )      | ) (296 )  |
| Current period other comprehensive income, net                   | (731 )                                                                                                             | (171 )      | ) (902 )  |
| Ending balance at June 30, 2014                                  | \$2,831                                                                                                            | \$ (1,947 ) | ) \$884   |

## Reclassifications Out of Accumulated Other Comprehensive Income

|                                                                    | Three<br>Months<br>Ended<br>June 30,<br>2014 | Six<br>Months<br>Ended<br>June 30,<br>2014 |
|--------------------------------------------------------------------|----------------------------------------------|--------------------------------------------|
| Details About Accumulated Other Comprehensive<br>Income Components |                                              |                                            |
| Amortization of pension and postretirement benefit plans:          |                                              |                                            |
| Prior service benefit (1)                                          | \$ (755 )                                    | ) \$(1,509 )                               |
| Unrecognized loss (1)                                              | 546                                          | 1,138                                      |
| Total before income tax                                            | (209 )                                       | ) (371 )                                   |
| Income tax benefit                                                 | 17                                           | 75                                         |
| Total reclassifications for the period                             | \$ (192 )                                    | ) \$(296 )                                 |

These accumulated other comprehensive income components are included in the computation of net periodic (1)pension and postretirement benefit costs, which are included in selling, general and administrative expenses in our consolidated statements of operations (see Note 11 for additional details).



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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 10. 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.

## Stock Option Grants

The following is a summary of the changes in outstanding stock options for the six months ended June 30, 2014:

|                                      | Shares   | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(Years) |
|--------------------------------------|----------|------------------------------------------|--------------------------------------------------------------------|
| Outstanding at December 31, 2013     | 16,875   | \$ 12.14                                 | 1.0                                                                |
| Expired                              | —        | —                                        | —                                                                  |
| Exercised                            | (7,000 ) | 13.76                                    | —                                                                  |
| Forfeited, other                     | —        | —                                        | —                                                                  |
| Outstanding at June 30, 2014         | 9,875    | \$ 10.99                                 | 0.9                                                                |
| Options exercisable at June 30, 2014 | 9,875    | \$ 10.99                                 | 0.9                                                                |

The aggregate intrinsic value of all outstanding stock options as of June 30, 2014 was \$0.3 million. All outstanding stock options as of June 30, 2014 are fully vested and exercisable. The total intrinsic value of options exercised was \$0.2 million for the six months ended June 30, 2014. There were no options granted in the six months ended June 30, 2014.

## Restricted and Performance Stock Grants

As part of the 2006 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. 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.





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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Our restricted and performance-based share activity was as follows for the six months ended June 30, 2014:

|                              | Shares    | Weighted<br>Average<br>Grant<br>Date Fair<br>Value<br>Per Share |
|------------------------------|-----------|-----------------------------------------------------------------|
| Balance at December 31, 2013 | 630,600   | \$ 19.47                                                        |
| Granted                      | 36,518    | 37.48                                                           |
| Vested                       | (18,075 ) | 26.35                                                           |
| Forfeited                    | (4,300 )  | 17.57                                                           |
| Balance at June 30, 2014     | 644,743   | \$ 20.40                                                        |

We recorded compensation expense related to restricted shares and performance-based shares of \$2 million (\$1.3 million, net of tax) and \$1.1 million (\$0.7 million, net of tax) for the six months ended June 30, 2014 and 2013, respectively. The unamortized compensation expense related to our restricted and performance-based shares was \$8.2 million at June 30, 2014, and is expected to be recognized as they vest over a weighted average period of 4.9 years and 0.8 years for employees and directors, respectively.

## Note 11. Employee Benefits

The components of net periodic benefit cost (credit) for our defined benefit plans and postretirement benefit plans for the three months and six months ended June 30, 2014 and 2013 were as follows (in thousands):

|                                    | Three Months<br>Ended<br>June 30, |          | Six Months<br>Ended<br>June 30, |          |
|------------------------------------|-----------------------------------|----------|---------------------------------|----------|
|                                    | 2014                              | 2013     | 2014                            | 2013     |
| Pension benefits                   |                                   |          |                                 |          |
| Service cost                       | \$41                              | \$45     | \$82                            | \$90     |
| Interest cost                      | 65                                | 58       | 130                             | 117      |
| Amortization of prior service cost | —                                 | 7        | —                               | 14       |
| Actuarial net loss                 | 58                                | 171      | 115                             | 345      |
| Net periodic benefit cost          | \$ 164                            | \$ 281   | \$ 327                          | \$ 566   |
| Postretirement benefits            |                                   |          |                                 |          |
| Service cost                       | \$—                               | \$—      | \$—                             | \$1      |
| Interest cost                      | 7                                 | 10       | 15                              | 19       |
| Amortization of prior service cost | (755)                             | (1,087)  | (1,509)                         | (2,174)  |
| Actuarial net loss                 | 488                               | 605      | 1,023                           | 1,216    |
| Net periodic benefit credit        | \$(260)                           | \$(472 ) | \$(471 )                        | \$(938 ) |

For the six months ended June 30, 2014, we made employee benefit contributions of \$0.5 million related to our postretirement plans. Based on current estimates, we believe we will be required to make approximately \$1 million in contributions for 2014.

We maintain a Supplemental Executive Retirement Plan (“SERP”) for key employees. Under the plan, these employees may elect to defer a portion of their compensation and, in addition, we may at our discretion make contributions to the plan on behalf of the employees. In March 2014, contributions of \$0.4 million were made to the plan related to calendar year 2013.

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 2014, we contributed to the trust an additional 58,570 shares from our treasury and released 58,600 shares from the trust leaving 400 shares remaining in the trust as of June 30, 2014.

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

## Note 12. Fair Value Measurements

We follow a three-level fair value hierarchy that prioritizes the inputs to measure fair value. This hierarchy requires entities to maximize the use of “observable inputs” and minimize the use of “unobservable inputs.” The three levels of inputs used to measure fair value are as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect assumptions that market participants would use in pricing an asset or liability.

The following is a summary of the carrying amounts and estimated fair values of our financial instruments at June 30, 2014 and December 31, 2013 (in thousands):

|                           | June 30, 2014   |            | December 31, 2013 |            |
|---------------------------|-----------------|------------|-------------------|------------|
|                           | Carrying Amount | Fair Value | Carrying Amount   | Fair Value |
| Cash and cash equivalents | \$6,217         | \$6,217    | \$5,559           | \$5,559    |
| Deferred compensation     | 9,800           | 9,800      | 8,289             | 8,289      |
| Short term borrowings     | 59,094          | 59,094     | 21,465            | 21,465     |
| Long-term debt            | 8               | 8          | 16                | 16         |

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 underlying assets held by the deferred compensation plan are based on the quoted market prices of the funds in registered investment companies, which are considered Level 1 inputs. 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.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 13. 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<br>Ended<br>June 30,<br>2014 |           | Six Months Ended<br>June 30,<br>2014 |           | 2013 | 2013 |
|------------------------------------------------------------|-------------------------------------------|-----------|--------------------------------------|-----------|------|------|
| Basic Net Earnings Per Common Shares:                      |                                           |           |                                      |           |      |      |
| Earnings from continuing operations                        | \$ 11,169                                 | \$ 16,400 | \$ 23,576                            | \$ 25,966 |      |      |
| Loss from discontinued operations                          | (529 )                                    | (357 )    | (1,211 )                             | (749 )    |      |      |
| Net earnings available to common stockholders              | \$ 10,640                                 | \$ 16,043 | \$ 22,365                            | \$ 25,217 |      |      |
| Weighted average common shares outstanding                 | 22,874                                    | 22,981    | 22,910                               | 22,918    |      |      |
| Earnings from continuing operations per common share       | \$0.49                                    | \$0.71    | \$1.03                               | \$1.13    |      |      |
| Loss from discontinued operations per common share         | (0.02 )                                   | (0.01 )   | (0.05 )                              | (0.03 )   |      |      |
| Basic net earnings per common share                        | \$0.47                                    | \$0.70    | \$0.98                               | \$1.10    |      |      |
| Diluted Net Earnings Per Common Share:                     |                                           |           |                                      |           |      |      |
| Earnings from continuing operations                        | \$ 11,169                                 | \$ 16,400 | \$ 23,576                            | \$ 25,966 |      |      |
| Loss from discontinued operations                          | (529 )                                    | (357 )    | (1,211 )                             | (749 )    |      |      |
| Net earnings available to common stockholders              | \$ 10,640                                 | \$ 16,043 | \$ 22,365                            | \$ 25,217 |      |      |
| Weighted average common shares outstanding                 | 22,874                                    | 22,981    | 22,910                               | 22,918    |      |      |
| Plus incremental shares from assumed conversions:          |                                           |           |                                      |           |      |      |
| Dilutive effect of restricted and performance-based shares | 318                                       | 273       | 303                                  | 264       |      |      |
| Dilutive effect of stock options                           | 5                                         | 7         | 6                                    | 8         |      |      |
| Weighted average common shares outstanding – Diluted       | 23,197                                    | 23,261    | 23,219                               | 23,190    |      |      |
| Earnings from continuing operations per common share       | \$0.48                                    | \$0.71    | \$1.02                               | \$1.12    |      |      |
| Loss from discontinued operations per common share         | (0.02 )                                   | (0.02 )   | (0.06 )                              | (0.03 )   |      |      |
| Diluted net earnings per common share                      | \$0.46                                    | \$0.69    | \$0.96                               | \$1.09    |      |      |

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<br>Months<br>Ended<br>June 30,<br>2014 |     | Six Months<br>Ended<br>June 30,<br>2014 |     | 2013 | 2013 |
|-----------------------------------------|----------------------------------------------|-----|-----------------------------------------|-----|------|------|
| Stock options                           | 5                                            | 10  | 4                                       | 10  |      |      |
| Restricted and performance-based shares | 295                                          | 234 | 300                                     | 243 |      |      |



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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 14. 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 distributes 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 and operating income by our operating segments (in thousands):

|                      | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|----------------------|--------------------------------|------------|------------------------------|------------|
|                      | 2014                           | 2013       | 2014                         | 2013       |
| Net Sales            |                                |            |                              |            |
| Engine Management    | \$ 184,181                     | \$ 182,050 | \$ 363,475                   | \$ 357,559 |
| Temperature Control  | 85,660                         | 86,660     | 137,145                      | 139,388    |
| All Other            | 2,699                          | 1,416      | 4,672                        | 3,887      |
| Consolidated         | \$ 272,540                     | \$ 270,126 | \$ 505,292                   | \$ 500,834 |
| Intersegment Revenue |                                |            |                              |            |
| Engine Management    | \$ 6,231                       | \$ 7,566   | \$ 12,184                    | \$ 13,019  |
| Temperature Control  | 2,133                          | 1,546      | 4,367                        | 3,055      |
| All Other            | (8,364 )                       | (9,112 )   | (16,551 )                    | (16,074 )  |
| Consolidated         | \$ —                           | \$ —       | \$ —                         | \$ —       |
| Operating Income     |                                |            |                              |            |
| Engine Management    | \$ 27,112                      | \$ 24,704  | \$ 51,484                    | \$ 45,488  |
| Temperature Control  | 4,991                          | 6,740      | 5,604                        | 6,286      |
| All Other (1)        | (14,483 )                      | (4,224 )   | (19,063 )                    | (8,524 )   |
| Consolidated         | \$ 17,620                      | \$ 27,220  | \$ 38,025                    | \$ 43,250  |

(1) During the second quarter of 2014, we recorded a \$10.6 million litigation charge in connection with a tentative settlement agreement in a legal proceeding with a third party (see Note 15 for additional details).

## Note 15. 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 June 30, 2014, approximately 2,180 cases were outstanding for which we may be responsible for any related liabilities. Since inception in September 2001 through June 30, 2014, the amounts paid for settled claims are approximately \$16.2 million. We acquired limited insurance coverage up to a fixed amount for defense and indemnity costs associated with certain asbestos-related claims and

have exhausted all insurance coverage.

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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, 2013. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs and any potential recovery from insurance carriers, ranging from \$24.4 million to \$37.4 million for the period through 2058. The change from the prior year study was a \$2.7 million decrease for the low end of the range and a \$4.1 million decrease for the high end of the range. The decrease 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. 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, 2013 actuarial study, no adjustment to the asbestos liability was recorded in our consolidated financial statements as the difference between our recorded liability and the liability in the actuarial report at the low end of the range was not material. 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 \$27.4 million to \$48.1 million for the period through 2058.

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.

Litigation Charge

During the second quarter 2014, we reached a tentative settlement in a legal proceeding with a third party for \$10.6 million. The legal proceeding resulted from the default of a loan by a former supplier and its related businesses and our subsequent purchases of product from a third party that was alleged to be a controlled company of the original supplier. Since the inception of the legal proceeding against us, we vigorously opposed all such allegations and believed that we had meritorious defenses. Prior to reaching the tentative settlement, we considered that the incurrence of a loss contingency related to the lawsuit was not reasonably possible. Accordingly, we did not record any provisions in our financial statements since our potential liability was not considered probable and reasonably estimable. During the second quarter 2014, at the time of the tentative settlement, we recorded the settlement amount of \$10.6 million. The settlement remains subject to court approval, and payment of the settlement amount is expected to be made in the third quarter of 2014 after the court has approved the settlement. The settlement amount will be funded from cash on hand and available credit under our revolving credit facility. We do not have any insurance on this matter.



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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## 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 one of our divestitures, 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.

## Warranties

We generally warrant our products against certain manufacturing and other defects. These product warranties are provided for specific periods of time of the product depending on the nature of the product. As of June 30, 2014 and 2013, we have accrued \$22.8 million and \$23.5 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<br>Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--------------------------------------------|-----------------------------------|----------|------------------------------|----------|
|                                            | 2014                              | 2013     | 2014                         | 2013     |
| Balance, beginning of period               | \$20,374                          | \$19,414 | \$18,041                     | \$17,288 |
| Liabilities accrued for current year sales | 22,425                            | 22,020   | 41,616                       | 40,376   |
| Settlements of warranty claims             | (19,998)                          | (17,936) | (36,856)                     | (34,166) |
| Balance, end of period                     | \$22,801                          | \$23,498 | \$22,801                     | \$23,498 |

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

This Report contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this Report are indicated by words such as “anticipates,” “expects,” “believes,” “intends,” “plans,” “estimates,” “projects,” “strategies” and similar expressions. These statements represent 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; 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 and original equipment service markets; changes in the product mix and distribution channel mix; economic and market conditions (including access to credit and financial markets); our significant indebtedness; successful integration of acquired businesses; our ability to achieve cost savings from our restructuring initiatives; litigation, 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 an increasing focus on the original equipment service market. We are organized into two major operating segments, each of which focuses on specific lines of replacement parts. Our Engine Management Segment manufactures 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 warehouse distributors, large retail chains, original equipment manufacturers and original equipment service part operations in the United States, Canada and Latin America. Our customers consist of many of the leading warehouse distributors, such as CARQUEST Corporation and NAPA Auto Parts, as well as many of the leading auto parts retail chains, such as Advance Auto Parts, Inc., AutoZone, Inc., O’Reilly Automotive, Inc., Canadian Tire Corporation Limited and The Pep Boys Manny, Moe & Jack. Our customers also include national program distribution groups, such as Federated Auto Parts Distributors, Inc., Auto Value and All Pro/Bumper to Bumper (Aftermarket Auto Parts Alliance, Inc.), Automotive Distribution Network LLC and The National Pronto Association, and specialty market distributors. We distribute parts under our own brand names, such as Standard®, BWD®, Intermotor®, GP Sorensen®, TechSmart®, OEM®, LockSmart®, Four Seasons®, Factory Air®, EVERCO®, ACi®, Imperial®, COMPRESSORWORKS®, TORQFLO® and Hayden® and through private labels, such as CARQUEST®, Duralast®, Duralast Gold®, Import Direct®, Master Pro®, Murray®, NAPA®, Cold Power® NAPA® Echlin®, Mileage Plus®, NAPA® Temp Products™ and NAPA® Belden®.

Our goal is to grow revenues and earnings and deliver returns in excess of our cost of capital by providing high quality original equipment and replacement 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 countries such as those in Asia.

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**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 2013, may lessen the demand for our Temperature Control products, while a hot summer may increase such demand. As a result of this seasonality and variability in demand of our Temperature Control products, our working capital requirements 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 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 installer error. In addition to warranty returns, we also permit our customers to return products to us within customer-specific limits (which are generally limited to a specified percentage of their annual purchases from us) in the event that they have overstocked their inventories. We accrue for overstock returns as a percentage of sales, after giving consideration to recent returns history.

In order to better control warranty and overstock return levels, we have in place procedures for authorized warranty returns, including for warranty returns which result from installer error, placed restrictions on the amounts customers can return and instituted a program to better estimate potential future product returns. In addition, with respect to our air conditioning compressors, which are our most significant customer product warranty returns, we established procedures whereby a warranty will be voided if a customer does not provide acceptable proof that complete air conditioning system repair was performed.

**Discounts, Allowances and Incentives.** In connection with our sales activities, we offer a variety of usual customer discounts, allowances and incentives. First, we offer cash discounts for paying invoices in accordance with the specified 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.

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## Interim Results of Operations:

## Comparison of the Three Months Ended June 30, 2014 to the Three Months Ended June 30, 2013

**Sales.** Consolidated net sales for the three months ended June 30, 2014 were \$272.5 million, an increase of \$2.4 million compared to \$270.1 million in the same period of 2013. Consolidated net sales increased primarily due to higher sales in the retail market of our Engine Management Segment as compared to the second quarter of 2013, which more than offset the lower results achieved by our Temperature Control Segment.

The following table summarizes net sales by segment for the quarters ended June 30, 2014 and 2013, respectively:

| Three Months Ended<br>June 30,<br><u>2014</u> | Engine<br>Management | Temperature<br>Control | Other   | Total     |
|-----------------------------------------------|----------------------|------------------------|---------|-----------|
| Net sales                                     | \$ 184,181           | \$ 85,660              | \$2,699 | \$272,540 |
| Gross margins                                 | 56,059               | 18,299                 | 3,041   | 77,399    |
| Gross margin percentage                       | 30.4                 | % 21.4                 | % —     | 28.4 %    |
| <u>2013</u>                                   |                      |                        |         |           |
| Net sales                                     | \$ 182,050           | \$ 86,660              | \$1,416 | \$270,126 |
| Gross margins                                 | 54,380               | 20,342                 | 3,074   | 77,796    |
| Gross margin percentage                       | 29.9                 | % 23.5                 | % —     | 28.8 %    |

Engine Management's net sales increased \$2.1 million, or 1.2%, to \$184.2 million for the second quarter of 2014. A year-over-year increase in net sales was achieved in the retail market as compared to the second quarter of 2013, which more than offset the lower net sales achieved in the traditional and OE/OES markets.

Temperature Control's net sales decreased \$1 million, or 1.2%, to \$85.7 million for the second quarter of 2014. The year-over-year decrease in net sales at Temperature Control resulted from the lower results achieved in the traditional and retail markets offset, in part, by the higher net sales achieved in the OE/OES and specialty markets. Included in the second quarter 2014 are incremental sales of \$2.6 million from our asset acquisition of Annex Manufacturing, acquired in April 2014. Excluding the incremental sales from the acquisition, Temperature Control net sales decreased \$3.6 million compared to the second quarter 2013. Demand for our Temperature Control products during the second and third quarter of each year may vary significantly with summer weather conditions and customer inventories.

**Gross Margins.** Gross margins, as a percentage of consolidated net sales, decreased to 28.4% in the second quarter of 2014, compared to 28.8% in the second quarter of 2013. Compared to the second quarter of 2013, gross margins at Engine Management increased 0.5 percentage points from 29.9% to 30.4%, while gross margins at Temperature Control decreased 2.1 percentage points from 23.5% to 21.4%. The gross margin percentage improvement in Engine Management compared to the prior year was primarily the result of increased volume, improved global sourcing, and manufacturing efficiencies, including the increase in manufacturing at our lower cost facilities. The gross margin percentage decline in Temperature Control compared to the prior year resulted primarily from lower production volumes to bring inventories in line with anticipated market demand.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses ("SG&A") decreased by \$1.7 million to \$48.8 million, or 17.9% of consolidated net sales, in the second quarter of 2014, as compared to \$50.6 million, or 18.7% of consolidated net sales, in the second quarter of 2013. The decrease in SG&A expenses as compared to the second quarter of 2013 is principally due to lower employee benefit costs and savings from the integration of the CompressorWorks acquisition.

Litigation Charge. During the second quarter 2014, we recorded a \$10.6 million litigation charge in connection with a tentative settlement agreement in a legal proceeding with a third party. The settlement agreement remains subject to court approval, and payment of the settlement amount is expected to be made in the third quarter of 2014 after the court has approved the settlement. The settlement amount will be funded from cash on hand and available credit under our revolving credit facility. See Note 15 of the notes to our consolidated financial statements for additional information.

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Restructuring and Integration Expenses. Restructuring and integration expenses increased to \$0.6 million in the second quarter of 2014, compared to \$0.2 million for the same period in 2013. Components of our restructuring and integration accruals, by segment, were as follows (in thousands):

|                                           | Engine<br>Management | Temperature<br>Control | Other    | Total    |
|-------------------------------------------|----------------------|------------------------|----------|----------|
| Exit activity liability at March 31, 2014 | \$ 1,509             | \$ 422                 | \$ 1,152 | \$ 3,083 |
| Restructuring and integration costs:      |                      |                        |          |          |
| Amounts provided for during 2014          | 507                  | 48                     | —        | 555      |
| Cash payments                             | (294 )               | (131 )                 | (465 )   | (890 )   |
| Exit activity liability at June 30, 2014  | \$ 1,722             | \$ 339                 | \$ 687   | \$ 2,748 |

Other Income, net. Other income, net, increased \$0.1 million in the second quarter of 2014 to \$0.3 million compared to \$0.2 million in the second quarter of 2013. During 2014 and 2013, we recognized \$0.3 million of deferred gain related to the sale-leaseback of our Long Island City, New York facility and in 2013, we recorded a \$0.1 million loss on the disposal of certain machinery and equipment.

Operating Income. Operating income was \$17.6 million in the second quarter of 2014, compared to \$27.2 million in the second quarter of 2013. Included in second quarter 2014 operating income is a \$10.6 million litigation charge in connection with a tentative settlement agreement in a legal proceeding with a third party.

Interest Expense. Interest expense decreased to \$0.5 million in the second quarter of 2014, compared to \$0.6 million in the second quarter of 2013, as average outstanding borrowings and average interest rates during the quarter declined year-over-year. The year-over-year decline in interest rates reflects the impact of the lower interest rates in our May 2013 amendment to our restated credit agreement.

Income Tax Provision. The income tax provision in the second quarter of 2014 was \$6.3 million at an effective tax rate of 36.1% compared to \$10.1 million at an effective tax rate of 38.1% for the same period in 2013. The lower year-over-year effective tax rate is the result of the mix of pre-tax income from the U.S. to the lower foreign tax rate jurisdictions.

Loss from Discontinued Operations. Loss from discontinued operations, net of tax, reflects legal expenses associated with our asbestos-related liability. We recorded \$0.5 million and \$0.4 million as a loss from discontinued operations for the second quarter of 2014 and 2013, respectively. As discussed more fully in Note 15 in the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

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Comparison of the Six Months Ended June 30, 2014 to the Six Months Ended June 30, 2013

Sales. Consolidated net sales for the six months ended June 30, 2014 were \$505.3 million, an increase of \$4.5 million compared to \$500.8 million in the same period of 2013. Consolidated net sales increased primarily due to higher sales in the retail market of our Engine Management Segment as compared to the first six months of 2013, which more than offset the lower results achieved by our Temperature Control Segment.

The following table summarizes net sales and gross margins by segment for the six months ended June 30, 2014 and 2013, respectively:

| Six Months Ended<br>June 30,<br><u>2014</u> | Engine<br>Management | Temperature<br>Control | Other   | Total     |
|---------------------------------------------|----------------------|------------------------|---------|-----------|
| Net sales                                   | \$ 363,475           | \$ 137,145             | \$4,672 | \$505,292 |
| Gross margins                               | 109,254              | 30,184                 | 5,871   | 145,309   |
| Gross margin percentage                     | 30.1                 | % 22                   | % —     | 28.8 %    |
| <u>2013</u>                                 |                      |                        |         |           |
| Net sales                                   | \$ 357,559           | \$ 139,388             | \$3,887 | \$500,834 |
| Gross margins                               | 106,094              | 31,328                 | 6,202   | 143,624   |
| Gross margin percentage                     | 29.7                 | % 22.5                 | % —     | 28.7 %    |

Engine Management's net sales increased \$5.9 million, or 1.7%, to \$363.5 million for the first six months of 2014. A year-over-year increase in net sales was achieved in the retail market as compared to the first six months of 2013, which more than offset the lower net sales achieved in the traditional market.

Temperature Control's net sales decreased \$2.2 million, or 1.6%, to \$137.1 million for the first six months of 2014. The year-over-year decrease in net sales at Temperature Control resulted from the lower results achieved in the traditional and retail markets offset, in part, by the higher net sales achieved in the OE/OES and specialty markets. Included in the first six months of 2014 are incremental sales of \$2.6 million from our asset acquisition of Annex Manufacturing, acquired in April 2014. Excluding the incremental sales from the acquisition, Temperature Control net sales decreased \$4.8 million compared to the first six months of 2013. Demand for our Temperature Control products during the second and third quarter of each year may vary significantly with summer weather conditions and customer inventories.

Gross Margins. Gross margins, as a percentage of consolidated net sales, for the six months ended June 30, 2014 was essentially flat at 28.8%, as compared to 28.7% during the same period in 2013. Compared to the first six months of 2013, gross margins at Engine Management increased 0.4 percentage points from 29.7% to 30.1%, while gross margins at Temperature Control decreased 0.5 percentage points from 22.5% to 22%. The gross margin percentage improvement in Engine Management compared to the prior year was primarily the result of increased volume, improved global sourcing and manufacturing efficiencies, including the increase in manufacturing at our lower cost facilities. The gross margin percentage decline in Temperature Control compared to the prior year resulted primarily from lower production volumes to bring inventories in line with anticipated market demand.

Selling, General and Administrative Expenses. SG&A decreased by \$3.8 million to \$96.4 million, or 19.1% of consolidated net sales, in the six months ended June 30, 2014, as compared to \$100.2 million, or 20% of consolidated net sales, in the same period of 2013. The decrease in SG&A expenses as compared to the first six months of 2013 is principally due to lower employee benefit costs and savings from the integration of the CompressorWorks acquisition.

Litigation Charge. During the second quarter 2014, we recorded a \$10.6 million litigation charge in connection with a tentative settlement agreement in a legal proceeding with a third party. The settlement agreement remains subject to court approval, and payment of the settlement amount is expected to be made in the third quarter of 2014 after the court has approved the settlement. The settlement amount will be funded from cash on hand and available credit under our revolving credit facility. See Note 15 of the notes to our consolidated financial statements for additional information.

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Restructuring and Integration Expenses. Restructuring and integration expenses increased to \$0.7 million for the six months ended June 30, 2014, compared to \$0.6 million for the same period in 2013.

Components of our restructuring and integration accruals, by segment, were as follows (in thousands):

|                                              | Engine<br>Management | Temperature<br>Control | Other   | Total   |
|----------------------------------------------|----------------------|------------------------|---------|---------|
| Exit activity liability at December 31, 2013 | \$ 1,556             | \$ 567                 | \$1,619 | \$3,742 |
| Restructuring and integration costs:         |                      |                        |         |         |
| Amounts provided for during 2014             | 678                  | 48                     | —       | 726     |
| Cash payments                                | (512 )               | (276 )                 | (932 )  | (1,720) |
| Exit activity liability at June 30, 2014     | \$ 1,722             | \$ 339                 | \$687   | \$2,748 |

Other Income, Net. Other income, net, increased \$0.1 million for the six months ended June 30, 2014 to \$0.5 million compared to \$0.4 million in the same period in 2013. During 2014 and 2013, we recognized \$0.5 million of deferred gain related to the sale-leaseback of our Long Island City, New York facility and in 2013, we recorded a \$0.1 million loss on the disposal of certain machinery and equipment.

Operating Income. Operating income was \$38 million in the first six months of 2014, compared to \$43.3 million for the same period in 2013. Included in operating income in the first six months of 2014 is a \$10.6 million litigation charge in connection with a tentative settlement agreement in a legal proceeding with a third party.

Interest Expense. Interest expense decreased by \$0.4 million to \$0.8 million in the six months ended June 30, 2014, compared to \$1.2 million for the same period in 2013, as average outstanding borrowings and average interest rates declined year-over-year. The year-over-year decline in interest rates reflects the impact of the lower interest rates in our May 2013 amendment to our revolving credit facility.

Income Tax Provision. The income tax provision for the six months ended June 30, 2014 was \$13.6 million at an effective tax rate of 36.5%, compared to \$15.8 million and an effective tax rate of 37.8% for the same period in 2013.

Loss from Discontinued Operations. Loss from discontinued operations, net of tax, reflects legal expenses associated with our asbestos-related liability. We recorded \$1.2 million and \$0.7 million as a loss from discontinued operations for the six months ended June 30, 2014 and 2013, respectively. As discussed more fully in Note 15 in the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

#### Restructuring and Integration Costs

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, 2013 and June 30, 2014 and activity for the six months ended June 30, 2014 consisted of the following (in thousands):

|                                              | Workforce<br>Reduction | Other<br>Exit<br>Costs | Total   |
|----------------------------------------------|------------------------|------------------------|---------|
| Exit activity liability at December 31, 2013 | \$ 2,800               | \$942                  | \$3,742 |
| Restructuring and integration costs:         |                        |                        |         |
| Amounts provided for during 2014             | 424                    | 302                    | 726     |
| Cash payments                                | (1,339 )               | (381 )                 | (1,720) |
| Exit activity liability at June 30, 2014     | \$ 1,885               | \$863                  | \$2,748 |



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Liabilities associated with the remaining restructuring and integration costs as of June 30, 2014 relate primarily to employee severance and other retiree benefit enhancements to be paid through 2017 and environmental clean-up costs at our Long Island City, New York location in connection with the closure of our manufacturing operations at the site.

## Liquidity and Capital Resources

**Operating Activities.** During the first six months of 2014, cash provided by operations was \$17.6 million compared to cash used in operations of \$12.4 million in the same period of 2013. The year-over-year increase in operating cash flow is primarily the result of a smaller year-over-year increase in accounts receivable of \$16.1 million compared to the year-over-year increase in accounts receivable of \$53.7 million in 2013 and the smaller year-over-year increase in inventory of \$19.5 million compared to the year-over-year increase in inventory of \$31.9 million in 2013. The increase in accounts receivable and inventory balances reflects the seasonality in our business.

**Investing Activities.** Cash used in investing activities was \$44.1 million in the first six months of 2014, as compared to \$18.9 million in the first six months of 2013. Investing activities in 2014 consist of (1) our acquisition of certain net assets of Pensacola Fuel Injection Inc., our primary vendor for rebuilt diesel fuel injectors and other related diesel products, for \$12.2 million, (2) our acquisition of a 50% interest in the joint venture with Gwo Yng Enterprise Co., Ltd., a China based manufacturer of air conditioning accumulators, filter driers, hose assemblies, and switches for the automotive aftermarket and OEM/OES markets for \$14 million, (3) our acquisition of certain net assets of Annex Manufacturing of Fort Worth, Texas, a distributor of a variety of temperature control products for the automotive aftermarket, for \$11.5 million and (4) capital expenditures of \$6.4 million. Investing activities in 2013 consisted primarily of (1) our acquisition of an approximate 25% minority interest in Orange Electronic Co. Ltd., our supplier of tire pressure monitoring systems located in Taiwan, for \$6.3 million, (2) our acquisition of the original equipment business of Standard Motor Products Holdings Ltd., our former affiliate in the U.K., for \$6.5 million, and (3) \$5.6 million in capital expenditures.

**Financing Activities.** Cash provided by financing activities was \$27.8 million in the first six months of 2014, compared to \$31.9 million in the same period of 2013. Borrowings under our revolving credit facility in 2014 and 2013 were used to fund acquisitions and business investments; fund capital expenditures; fund the purchase of our common stock; pay dividends; and fund the cash used in operating activities in 2013. In 2014, we purchased 166,890 shares of our common stock for \$5.9 million compared to the purchase of 41,301 shares of our common stock for \$1.2 million in 2013. Dividends of \$6 million were paid in the first six months of 2014 compared to \$5 million in the comparable period during the prior year. In February 2014, our Board of Directors voted to increase our quarterly dividend from \$0.11 per share in 2013 to \$0.13 per share in 2014.

In November 2010, we entered into a Third Amended and Restated Credit Agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The restated credit agreement (as amended) provides for a line of credit of up to \$250 million (inclusive of the Canadian revolving credit facility described below) and expires in March 2018. Direct borrowings under the restated credit agreement bear interest at the LIBOR rate plus the applicable margin (as defined), or floating at the index rate plus the applicable margin, at our option. The interest rate may vary depending upon our borrowing availability. The restated credit agreement is guaranteed by certain of our subsidiaries and secured by certain of our assets.

In February 2013, we amended the restated credit agreement to provide us with greater flexibility regarding the payment of cash dividends and stock repurchases. In May 2013, we further amended our restated credit agreement (1) to extend the maturity date of our credit facility to March 2018; (2) to increase the line of credit from \$200 million to \$250 million (inclusive of the Canadian revolving credit facility described below); (3) to reduce the margin added to the LIBOR rate to 1.50% - 2%; (4) to reduce the margin added to the index rate to 0.50% - 1%; (5) to reduce the unused fee to 0.25%; and (6) to provide us with greater flexibility regarding acquisitions, other permissible debt financing, cash held and capital expenditures, among other matters.



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Borrowings under the restated credit agreement are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. After taking into account outstanding borrowings under the restated credit agreement, there was an additional \$164 million available for us to borrow pursuant to the formula at June 30, 2014. Outstanding borrowings under the restated credit agreement (inclusive of the Canadian revolving credit facility described below), which are classified as current liabilities, were \$59.1 million and \$21.4 million at June 30, 2014 and December 31, 2013, 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 June 30, 2014, the weighted average interest rate on our restated credit agreement was 1.8%, which consisted of \$56 million in direct borrowings at 1.7% and an index loan of \$3.1 million at 3.8%. At December 31, 2013, the weighted average interest rate on our restated credit agreement was 2%, which consisted of \$18 million in direct borrowings at 1.7% and an index loan of \$3.4 million at 3.8%. During the six months ended June 30, 2014, our average daily index loan balance was \$4.5 million compared to \$4.9 million for the six months ended June 30, 2013 and \$4.1 million for the year ended December 31, 2013.

At any time that our average borrowing availability is less than \$25 million, the terms of our restated credit agreement provide for, among other provisions, a financial covenant requiring us, on a consolidated basis, to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months). As of June 30, 2014, we were not subject to these covenants. Availability under our restated credit agreement is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. Our restated credit agreement also permits dividends and distributions by us provided specific conditions are met.

In May 2010, we amended our Canadian Credit Agreement with GE Canada Finance Holding Company, for itself and as agent for the lenders. The amended Canadian Credit Agreement provided for the conversion of the then existing \$10 million line of credit into a revolving credit facility. The Canadian \$10 million line of credit is part of the \$250 million available for borrowing under our restated credit agreement with General Electric Capital Corporation.

In May 2013, we further amended our Canadian Credit Agreement to extend the maturity date of the agreement to March 2018 and modify certain provisions, including interest rates, to parallel the revolving credit provisions of the restated credit agreement (described above). The amended credit agreement is guaranteed and secured by us and certain of our wholly-owned subsidiaries. Direct borrowings under the amended credit agreement bear interest at the same rate as our restated credit agreement with General Electric Capital Corporation. As of June 30, 2014, we have no outstanding borrowings under the Canadian Credit Agreement.

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 \$188.8 million and \$366.2 million of receivables during the three months and six months ended June 30, 2014, respectively, and \$183.9 million and \$334.3 million for the comparable periods in 2013. A charge in the amount of \$3.6 million and \$6.9 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 six months ended June 30, 2014, respectively, and \$3.9 million and \$7.1 million for the comparable periods in 2013. 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.





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In February 2014, our Board of Directors authorized the purchase of up to \$10 million of our common stock under a 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 six months ended June 30, 2014, we repurchased 36,656 shares and 166,890 shares, respectively, of our common stock at a total cost of \$1.3 million and \$5.9 million, respectively. As of June 30, 2014, there was approximately \$4.1 million available for future stock repurchases under the program.

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, 2013.

The following table summarizes our contractual commitments as of June 30, 2014 and expiration dates of commitments through 2023:

| (In thousands)                                              | 2014    | 2015     | 2016    | 2017    | 2018    | 2019-<br>2023 | Total    |
|-------------------------------------------------------------|---------|----------|---------|---------|---------|---------------|----------|
| Lease obligations                                           | \$3,766 | \$6,717  | \$5,686 | \$3,592 | \$2,259 | \$2,221       | \$24,241 |
| Postretirement and pension benefits                         | 1,034   | 6,921    | 1,280   | 63      | 57      | 74            | 9,429    |
| Severance payments related to restructuring and integration | 1,160   | 545      | 110     | 70      | —       | —             | 1,885    |
| Total commitments                                           | \$5,960 | \$14,183 | \$7,076 | \$3,725 | \$2,316 | \$2,295       | \$35,555 |

Indebtedness under our revolving credit facilities is not included in the table above as it is reported as a current liability in our consolidated balance sheets. As of June 30, 2014, amounts outstanding under our revolving credit facilities were \$59.1 million.

In addition, the table above does not include the tentative legal settlement amount of \$10.6 million, which is expected to be paid in the third quarter of 2014 upon court approval of the settlement.

### 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, 2013. 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.

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

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

We also evaluate inventories on a regular basis to identify inventory on hand that may be obsolete or in excess of current and future projected market demand. For inventory deemed to be obsolete, we provide a reserve on the full value of the inventory. Inventory that is in excess of current and projected use is reduced by an allowance to a level that approximates our estimate of future demand. 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. The production of air conditioning compressors involves the rebuilding of used cores, which we acquire either in outright purchases from used parts brokers or from returns pursuant to an exchange program with customers. Under such exchange programs, we reduce our inventory, through a charge to cost of sales, when we sell a finished good compressor, and put back to inventory the used core exchanged at standard cost through a credit to cost of sales when it is actually received from the customer.

**Sales Returns and Other Allowances and Allowance for Doubtful Accounts.** We must make estimates of potential future product returns related to current period product revenue. We analyze historical returns, current economic trends, and changes in customer demand when evaluating the adequacy of the sales returns and other allowances. Significant judgments and estimates must be made and used in connection with establishing the sales returns and other allowances in any accounting period. At June 30, 2014, the allowance for sales returns was \$40.7 million. Similarly, we must make estimates of the uncollectability of our accounts receivables. 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 June 30, 2014, the allowance for doubtful accounts and for discounts was \$6.7 million.

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

**Accounting for Income Taxes.** As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves

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

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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 pretax 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 \$6.7 million as of June 30, 2014 is intended to provide for the uncertainty regarding the ultimate realization of our state tax credit carryovers, U.S. capital loss carryforwards, and U.S. foreign tax credit 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. Interest and penalties 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.

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, then 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.

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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.

Retirement and 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, and FASB ASC 715, Retirement Benefits. The determination of defined benefit pension and 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 using an option-pricing model. 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 condensed 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.

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.



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**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, 2013 estimated an undiscounted liability for settlement payments, excluding legal costs and any potential recovery from insurance carriers, ranging from \$24.4 million to \$37.4 million for the period through 2058. 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, 2013 actuarial study, no adjustment to the asbestos liability was recorded in our consolidated financial statements as the difference between our recorded liability and the liability in the actuarial report at the low end of the range was not material. In addition, according to the updated study, legal costs, which are expensed as incurred and reported in earnings (loss) from discontinued operations, are estimated to range from \$27.4 million to \$48.1 million during the same period. 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. The aforementioned estimated settlement payments and legal costs do not reflect any coverage with insurance carriers for certain asbestos-related claims that we may obtain in the future.

**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

### Discontinued Operations and Disclosures of Disposals of Components of an Entity

In April 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (“ASU 2014-08”), which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and “represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results.” The new standard applies prospectively to new disposals and new classifications of disposal groups as held for sale after the effective date. The amendment is effective for annual reporting periods beginning after December 15, 2014, which for us is January 1, 2015, and interim periods within those annual periods. The adoption of this standard will not change the manner in which we currently present discontinued operations in our consolidated financial statements.

### Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. 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 new standard provides entities the option of using either a full retrospective or a modified approach to adopt the guidance. The new standard is effective for annual reporting periods beginning after December 15, 2016,

which for us is January 1, 2017, and interim periods within those annual periods. Early adoption is not permitted. We are currently evaluating the impact, if any, this new standard will have on our consolidated financial statements and have not yet determined the method of adoption.

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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 June 30, 2014, we did 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 June 30, 2014 and December 31, 2013, 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 offsetting effect of such a change on our foreign currency denominated revenues.

Interest Rate Risk

We manage our exposure to interest rate risk through the proportion of fixed rate debt and variable rate debt in our debt portfolio. To manage a portion of our exposure to interest rate changes, we have in the past entered into interest rate swap agreements. We invest our excess cash in highly liquid short-term investments. Our percentage of variable rate debt to total debt was 99.9% at June 30, 2014 and 99.6% at December 31, 2013.

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, 2013.

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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 June 30, 2014, we have not made any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

We continue to review, document and test our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in the 1992 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.

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PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In 1986, we acquired a brake business, which we subsequently sold in March 1998 and which is accounted for as a discontinued operation. When we originally acquired this brake business, we assumed future liabilities relating to any alleged exposure to asbestos-containing products manufactured by the seller of the acquired brake business. In accordance with the related purchase agreement, we agreed to assume the liabilities for all new claims filed on or after September 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 June 30, 2014, approximately 2,180 cases were outstanding for which we may be responsible for any related liabilities. Since inception in September 2001 through June 30, 2014, the amounts paid for settled claims are approximately \$16.2 million. We acquired limited insurance coverage up to a fixed amount for defense and indemnity costs associated with certain asbestos-related claims and have exhausted all insurance coverage.

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, 2013. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs and any potential recovery from insurance carriers, ranging from \$24.4 million to \$37.4 million for the period through 2058. The change from the prior year study was a \$2.7 million decrease for the low end of the range and a \$4.1 million decrease for the high end of the range. The decrease 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. 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, 2013 actuarial study, no adjustment to the asbestos liability was recorded in our consolidated financial statements as the difference between our recorded liability and the liability in the actuarial report at the low end of the range was not material. 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 \$27.4 million to \$48.1 million for the period through 2058.

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.

We are currently involved in various other legal claims and legal proceedings (some of which may involve substantial amounts), including claims related to one of our divestitures, 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.

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IndexITEM 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 second quarter of 2014:

| Period           | Total<br>Number of<br>Shares<br>Purchased<br>(1) | Average<br>Price<br>Paid<br>Per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans<br>or<br>Programs<br>(1) | Maximum<br>Number (or<br>Approximate<br>Dollar<br>Value) of<br>Shares that<br>may yet be<br>Purchased<br>Under the<br>Plans or<br>Programs (1) |
|------------------|--------------------------------------------------|------------------------------------------|--------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|
| April 1-30, 2014 | 36,656                                           | \$ 36.38                                 | 36,656                                                                                                             | \$ 4,140,377                                                                                                                                   |
| May 1-31, 2014   | —                                                | —                                        | —                                                                                                                  | —                                                                                                                                              |
| June 1-30, 2014  | —                                                | —                                        | —                                                                                                                  | —                                                                                                                                              |
| Total            | 36,656                                           | \$ 36.38                                 | 36,656                                                                                                             | \$ 4,140,377                                                                                                                                   |

In February 2014, our Board of Directors authorized the purchase of up to \$10 million of our common stock under a 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 six months ended (1) June 30, 2014, we repurchased 36,656 shares and 166,890 shares, respectively, of our common stock at a total cost of \$1.3 million and \$5.9 million, respectively. As of June 30, 2014, there was approximately \$4.1 million available for future stock repurchases under the program.

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ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

STANDARD MOTOR PRODUCTS, INC.  
(Registrant)

Date: August 1, 2014 /s/ James J. Burke  
James J. Burke  
Vice President Finance,  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)



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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES  
EXHIBIT INDEX

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.”