

STANDARD MOTOR PRODUCTS INC  
Form 10-Q  
October 28, 2016

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

FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

Commission file number: 1-4743

Standard Motor Products, Inc.

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of incorporation or organization)

11-1362020

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

37-18 Northern Blvd., Long Island City, N.Y. 11101

(Address of principal executive offices)

(Zip Code)

(718) 392-0200

(Registrant's telephone number, including area code)

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

Yes      No

Indicate by check mark whether the registrant has submitted electronically 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

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 October 26, 2016, there were 22,833,899 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 STATEMENTS

## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

| (In thousands, except share and per share data)            | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2016<br>(Unaudited)                 | 2015       | 2016<br>(Unaudited)                | 2015       |
| Net sales  | \$300,795                           | \$270,037  | \$828,683                          | \$767,008  |
| Cost of sales  | 205,151                             | 188,484    | 572,967                            | 548,806    |
| Gross profit   | 95,644                              | 81,553     | 255,716                            | 218,202    |
| Selling, general and administrative expenses               | 61,277                              | 51,907     | 169,033                            | 152,841    |
| Restructuring and integration expenses (income)            | 1,115                               | (80)       | 2,127                              | (49)       |
| Other income, net  | 322                                 | 231        | 881                                | 774        |
| Operating income   | 33,574                              | 29,957     | 85,437                             | 66,184     |
| Other non-operating income (expense), net                  | 208                                 | (535)      | 806                                | 164        |
| Interest expense   | 501                                 | 332        | 1,206                              | 1,238      |
| Earnings from continuing operations before taxes           | 33,281                              | 29,090     | 85,037                             | 65,110     |
| Provision for income taxes                                 | 12,226                              | 9,896      | 31,464                             | 22,769     |
| Earnings from continuing operations                        | 21,055                              | 19,194     | 53,573                             | 42,341     |
| Loss from discontinued operations, net of income taxes     | (425)                               | (728)      | (1,495)                            | (1,549)    |
| Net earnings   | \$20,630                            | \$18,466   | \$52,078                           | \$40,792   |
| <u>Per Share Data:</u>                                     |                                     |            |                                    |            |
| Net earnings per common share – Basic:                     |                                     |            |                                    |            |
| Earnings from continuing operations                        | \$0.93                              | \$0.84     | \$2.36                             | \$1.85     |
| Discontinued operations                                    | (0.02)                              | (0.03)     | (0.06)                             | (0.07)     |
| Net earnings per common share – Basic                      | \$0.91                              | \$0.81     | \$2.30                             | \$1.78     |
| Net earnings per common share – Diluted:                   |                                     |            |                                    |            |
| Earnings from continuing operations                        | \$0.91                              | \$0.83     | \$2.32                             | \$1.82     |
| Discontinued operations                                    | (0.02)                              | (0.03)     | (0.06)                             | (0.06)     |
| Net earnings per common share – Diluted                    | \$0.89                              | \$0.80     | \$2.26                             | \$1.76     |
| Dividend declared per share                                | \$0.17                              | \$0.15     | \$0.51                             | \$0.45     |
| Average number of common shares                            | 22,716,279                          | 22,770,865 | 22,688,071                         | 22,865,978 |
| Average number of common shares and dilutive common shares | 23,097,699                          | 23,133,869 | 23,044,604                         | 23,220,381 |

See accompanying notes to consolidated financial statements (unaudited).

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In thousands)   | Three Months Ended                   |           | Nine Months Ended                    |           |
|--|--------------------------------------|-----------|--------------------------------------|-----------|
|  | September 30,<br>2016<br>(Unaudited) | 2015      | September 30,<br>2016<br>(Unaudited) | 2015      |
| Net earnings   | \$ 20,630                            | \$ 18,466 | \$ 52,078                            | \$ 40,792 |
| Other comprehensive income (loss), net of tax:                 |                                      |           |                                      |           |
| Foreign currency translation adjustments                       | (188 )                               | (2,201 )  | (341 )                               | (4,453 )  |
| Pension and postretirement plans:                              |                                      |           |                                      |           |
| Amortization of:   |                                      |           |                                      |           |
| Prior service benefit  | (14 )                                | (27 )     | (41 )                                | (85 )     |
| Unrecognized loss  | 194                                  | 676       | 584                                  | 1,806     |
| Unrecognized actuarial gains                                   | —                                    | —         | 301                                  | 421       |
| Foreign currency exchange rate changes                         | —                                    | (53 )     | 4                                    | (20 )     |
| Income tax expense related to pension and postretirement plans | (75 )                                | (264 )    | (347 )                               | (872 )    |
| Pension and postretirement plans, net of tax                   | 105                                  | 332       | 501                                  | 1,250     |
| Total other comprehensive income (loss), net of tax            | (83 )                                | (1,869 )  | 160                                  | (3,203 )  |
| Comprehensive income   | \$ 20,547                            | \$ 16,597 | \$ 52,238                            | \$ 37,589 |

See accompanying notes to consolidated financial statements (unaudited).

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

|   | September<br>30,<br>2016<br>(Unaudited) | December<br>31,<br>2015 |
|---|---|-------------------------|
| (In thousands, except share and per share data)   |   |                         |
| <b>ASSETS</b>   |   |                         |
| <b>CURRENT ASSETS:</b>  |   |                         |
| Cash and cash equivalents   | \$ 30,537                               | \$ 18,800               |
| Accounts receivable, less allowances for discounts and doubtful accounts of \$4,623 and \$4,246 for 2016 and 2015, respectively | 161,726                                 | 123,853                 |
| Inventories   | 302,598                                 | 285,793                 |
| Deferred income taxes   | 42,003                                  | 40,626                  |
| Prepaid expenses and other current assets   | 5,893                                   | 10,668                  |
| Total current assets  | 542,757                                 | 479,740                 |
| Property, plant and equipment, net of accumulated depreciation of \$194,393 and \$194,077 for 2016 and 2015, respectively       | 77,081                                  | 68,882                  |
| Goodwill  | 67,151                                  | 54,881                  |
| Other intangibles, net  | 66,318                                  | 29,386                  |
| Deferred income taxes   | 8,315                                   | 10,737                  |
| Other assets  | 36,554                                  | 37,438                  |
| Total assets  | \$ 798,176                              | \$ 681,064              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |   |                         |
| <b>CURRENT LIABILITIES:</b>   |   |                         |
| Notes payable   | \$ 70,000                               | \$ 47,427               |
| Current portion of long-term debt   | 44                                      | 16                      |
| Accounts payable  | 88,168                                  | 72,711                  |
| Sundry payables and accrued expenses  | 49,121                                  | 40,706                  |
| Accrued customer returns  | 46,424                                  | 38,812                  |
| Accrued rebates   | 30,039                                  | 27,196                  |
| Payroll and commissions   | 30,485                                  | 17,048                  |
| Total current liabilities   | 314,281                                 | 243,916                 |
| Long-term debt  | 134                                     | 62                      |
| Other accrued liabilities   | 13,338                                  | 12,922                  |
| Accrued asbestos liabilities  | 31,884                                  | 32,185                  |
| Total liabilities   | 359,637                                 | 289,085                 |
| 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  | 97,246                                  | 93,247                  |
| Retained earnings   | 331,993                                 | 291,481                 |
| Accumulated other comprehensive income  | (6,314 )                                | (6,474 )                |

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|   |            |            |
|---|------------|------------|
| Treasury stock – at cost (1,219,757 shares and 1,295,316 shares in 2016 and 2015, respectively) | (32,258 )  | (34,147 )  |
| Total stockholders' equity  | 438,539    | 391,979    |
| Total liabilities and stockholders' equity  | \$ 798,176 | \$ 681,064 |

See accompanying notes to consolidated financial statements (unaudited).

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands)  | Nine Months Ended<br>September 30,<br>2016      2015<br>(Unaudited) |          |
|---|---|----------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |   |          |
| Net earnings  | \$52,078  | \$40,792 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |   |          |
| Depreciation and amortization   | 14,829  | 13,042   |
| Amortization of deferred financing cost   | 260   | 523      |
| Increase to allowance for doubtful accounts   | 266   | 288      |
| Increase to inventory reserves  | 3,800   | 901      |
| Amortization of deferred gain on sale of building                                   | (786 )  | (786 )   |
| Equity income from joint ventures   | (735 )  | (542 )   |
| Employee Stock Ownership Plan allocation  | 1,515   | 1,656    |
| Stock-based compensation  | 4,104   | 3,948    |
| Excess tax benefits related to exercise of employee stock grants                    | (140 )  | (169 )   |
| Decrease in deferred income taxes   | 802   | 577      |
| Loss on discontinued operations, net of tax   | 1,495   | 1,549    |
| Change in assets and liabilities:   |   |          |
| Increase in accounts receivable   | (35,192)  | (25,094) |
| (Increase) decrease in inventories  | (7,422 )  | 4,761    |
| Decrease in prepaid expenses and other current assets                               | 5,426   | 2,351    |
| Increase in accounts payable  | 9,900   | 8,383    |
| Increase in sundry payables and accrued expenses                                    | 31,016  | 21,711   |
| Net change in other assets and liabilities  | 1,752   | (1,059 ) |
| Net cash provided by operating activities   | 82,968  | 72,832   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |   |          |
| Acquisitions of and investments in businesses                                       | (67,289)  | —        |
| Capital expenditures  | (15,194)  | (14,612) |
| Other investing activities  | 191   | 32       |
| Net cash used in investing activities   | (82,292)  | (14,580) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |   |          |
| Net borrowings (repayments) under line-of-credit agreements                         | 22,573  | (32,056) |
| Net borrowings (payments) of long-term debt and capital lease obligations           | 99  | (171 )   |
| Purchase of treasury stock  | (377 )  | (15,519) |
| Increase (decrease) in overdraft balances   | 596   | (147 )   |
| Proceeds from exercise of employee stock options                                    | —   | 109      |
| Excess tax benefits related to the exercise of employee stock grants                | 140   | 169      |
| Dividends paid  | (11,566)  | (10,299) |
| Net cash provided by (used in) financing activities                                 | 11,465  | (57,914) |
| Effect of exchange rate changes on cash   | (404 )  | (707 )   |
| Net increase (decrease) in cash and cash equivalents                                | 11,737  | (369 )   |
| CASH AND CASH EQUIVALENTS at beginning of period                                    | 18,800  | 13,728   |
| CASH AND CASH EQUIVALENTS at end of period  | \$30,537  | \$13,359 |



Supplemental disclosure of cash flow information:

Cash paid during the period for:

|              |          |          |
|--------------|----------|----------|
| Interest     | \$933    | \$742    |
| Income taxes | \$21,271 | \$19,448 |

See accompanying notes to consolidated financial statements (unaudited).

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CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

Nine Months Ended September 30, 2016

(Unaudited)

|  | Common<br>Stock | Capital in<br>Excess of<br>Par Value | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Total      |
|--|-----------------|--------------------------------------|----------------------|---|-------------------|------------|
| (In thousands)                                       |                 |                                      |                      |   |                   |            |
| Balance at December 31, 2015                         | \$ 47,872       | \$ 93,247                            | \$ 291,481           | \$ (6,474 )   | \$(34,147)        | \$ 391,979 |
| Net earnings   | —               | —                                    | 52,078               | —   | —                 | 52,078     |
| Other comprehensive income (loss), net of<br>tax     | —               | —                                    | —                    | 160   | —                 | 160        |
| Cash dividends paid                                  | —               | —                                    | (11,566 )            | —   | —                 | (11,566 )  |
| Purchase of treasury stock                           | —               | —                                    | —                    | —   | (377 )            | (377 )     |
| Stock-based compensation and related tax<br>benefits | —               | 3,544                                | —                    | —   | 700               | 4,244      |
| Employee Stock Ownership Plan                        | —               | 455                                  | —                    | —   | 1,566             | 2,021      |
| Balance at September 30, 2016                        | \$ 47,872       | \$ 97,246                            | \$ 331,993           | \$ (6,314 )   | \$(32,258)        | \$ 438,539 |

See accompanying notes to consolidated financial statements (unaudited).

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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 as the “Company,” “we,” “us,” or “our”) is engaged in the manufacture and distribution of replacement parts for motor vehicles in the automotive aftermarket industry with a complementary focus on heavy duty, industrial equipment and the original equipment service market.

The accompanying unaudited financial information should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015. 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.

Note 2. Summary of Significant Accounting Policies

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

There have been no material changes to our critical accounting policies and estimates from the information provided in Note 1 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015.

Recently Issued Accounting Pronouncements

Leases

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, Leases (“ASU 2016-02”), which outlines the need to recognize a right-of-use asset and a lease liability for virtually all leases (other than leases that meet the definition of a short-term lease). For income statement purposes, the FASB retained the dual model, requiring leases to be classified as either operating or financing. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. The new standard

is effective for annual reporting periods beginning after December 15, 2018, which for us is January 1, 2019, and interim periods within those annual periods. The new standard must be adopted utilizing a modified retrospective transition, and provides for certain expedients. Early adoption is permitted. The new standard will require that we recognize all of our leases, including our current operating leases, on the balance sheet. We are currently evaluating the impact the new standard will have on our consolidated financial statements, and when we will adopt the new standard.

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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.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers – Deferral of the Effective Date (“ASU 2015-14”), which defers by one year the mandatory effective date of its revenue recognition standard, and provides entities the option to adopt the standard as of the original effective date. The new standard is now effective for annual reporting periods beginning after December 15, 2017, which for us is January 1, 2018, and interim periods within those annual periods. Early adoption is now permitted, but not before the original effective date, which for us is January 1, 2017. We are currently evaluating the impact, if any, this new standard will have on our consolidated financial statements, when we will adopt the new standard, and the method of adoption.

Improvements to Employee Share-Based Payment Accounting

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies various aspects related to how share-based payments are accounted for and presented in the financial statements. The new guidance requires (1) that the tax effects related to share-based payments at settlement (or expiration) be recorded through the tax provision (benefit) in the income statement rather than in equity as permitted under current guidance under certain circumstances; (2) that all tax-related cash flows resulting from share-based payments be reported as operating activities on the statement of cash flows, a change from the current requirement to present windfall tax benefits as an inflow from financing activities and an outflow from operating activities; and (3) that when computing diluted earnings per share, the effect of “windfall” tax benefits be excluded from the hypothetical proceeds used to calculate the repurchase of shares under the treasury stock method. 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 that reporting period. Early adoption is permitted. We do not anticipate that the adoption of ASU 2016-09 will have a material effect on our financial statements.

Balance Sheet Classification of Deferred Taxes

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, (“ASU 2015-17”), which requires entities with a classified balance sheet to present all deferred tax assets and liabilities as noncurrent. The new guidance requires entities to offset all deferred tax assets and liabilities (and valuation allowances) for each tax-paying jurisdiction within each tax-paying component. The net deferred tax must be presented as a single noncurrent amount. The new standard is effective for periods beginning after December 15, 2016, which for us is January 1, 2017. The new standard provides entities the option of either a retrospective or prospective approach to adopt the guidance. Early adoption is permitted. We do not anticipate that the adoption of ASU 2015-17 will have a material effect on our consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Simplifying the Measurement of Inventory

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory, (“ASU 2015-11”), which changes the measurement principle for inventory from the lower of cost or market to lower of cost and net realizable value for entities that do not measure inventory using the last-in, first-out, or retail inventory method. This ASU applies to all other inventory, which includes inventory that is measured using first-in, first-out or average cost. In addition, ASU 2015-11 eliminates the requirement for these entities to consider replacement cost or net realizable value less an approximate normal profit margin when measuring inventory. The new standard is effective for periods beginning after December 15, 2016, which for us is January 1, 2017. The new standard should be applied prospectively. Early adoption is permitted. We do not anticipate that the adoption of ASU 2015-11 will have a material effect on our consolidated financial statements.

Simplifying the Presentation of Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs, (“ASU 2015-03”), which requires that debt issuance costs be presented in the balance sheet as a direct deduction of the carrying value of the associated debt liability. Under the then existing guidance, debt issuance costs were required to be presented in the balance sheet as a deferred charge (i.e., an asset). The new standard is effective for periods beginning after December 15, 2015, which for us was January 1, 2016. Early adoption is permitted for financial statements that have not been previously issued. The new standard should be applied retrospectively to all periods presented in the financial statements.

In June 2015, at the Emerging Issues Task Force meeting, the FASB clarified that ASU 2015-03 does not address debt issuance costs related to revolving credit debt arrangements. In connection therewith, at the June 2015 meeting, the SEC staff announced that it would not object to the presentation of issuance costs related to revolving debt arrangements as an asset that is amortized over the term of the arrangement. In August 2015, the FASB issued ASU 2015-15, Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, which amended ASU 2015-03 to incorporate the conclusions reached by the SEC staff at its June 2015 Emerging Issues Task Force meeting. The adoption of the new standard did not change the manner in which we present debt financing costs related to our revolving credit facility as it is still presented as an asset in our consolidated balance sheets.

Simplifying the Accounting for Measurement-Period Adjustments

In September 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, (“ASU 2015-16”), which eliminates the requirement to restate prior period financial statements for measurement period adjustments related to business acquisitions. The new guidance requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. In addition, ASU 2015-16 requires that companies present separately on the face of the income statement, or disclose in the notes, the portion of the adjustment recorded in current period earnings by line item that would have been recorded in previous reporting periods if the adjustment had been recognized as of the acquisition date. The new standard is effective for periods beginning after December 15, 2015, which for us was January 1, 2016. The new standard should be applied prospectively to measurement period adjustments that occur after the effective date. Early adoption is permitted. We have adopted the new standard and will prospectively apply the new standard to measurement period adjustments related to all future business acquisitions.



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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 3. Business Acquisitions and Investments

In May 2016, we acquired the North American automotive ignition wire business of General Cable Corporation for approximately \$67.5 million, subject to post-closing adjustments. The acquisition was paid for in cash funded by our revolving credit facility with JPMorgan Chase, as agent. The acquisition includes the purchase of certain assets and the assumption of certain liabilities of General Cable Corporation's (and certain of its affiliates) automotive ignition wire business in North America as well as 100% of the equity interests of a General Cable subsidiary in Nogales, Mexico. Revenues generated from the acquired business were approximately \$96 million for the year ended December 31, 2015.

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

|  |          |          |
|--|----------|----------|
| Purchase Price                           |          | \$67,451 |
| Assets acquired and liabilities assumed: |          |          |
| Receivables                              | \$3,130  |          |
| Inventory                                | 12,567   |          |
| Other current and noncurrent assets (1)  | 334      |          |
| Property, plant and equipment, net       | 2,660    |          |
| Intangible assets                        | 42,440   |          |
| Goodwill                                 | 12,516   |          |
| Current liabilities                      | (6,196 ) |          |
| Net assets acquired                      |          | \$67,451 |

(1) Other current and noncurrent assets includes \$0.2 million of cash acquired.

Intangible assets acquired of \$42.4 million consists of customer relationships of \$39.4 million that will be amortized on a straight-line basis over the estimated useful life of 15 years; a non-compete agreement of \$2.2 million that will be amortized on a straight-line basis over the estimated useful life of 5 years; and a supply agreement of \$0.8 million that will be amortized on a straight-line basis over the estimated useful life of 1 year. Goodwill of \$12.5 million was allocated to the Engine Management Segment and is deductible for income tax purposes. The goodwill reflects relationships, business specific knowledge and the replacement cost of an assembled workforce associated with personal reputations, as well as the value of expected synergies.

Revenues included in our consolidated statements of operations for the acquisition was \$31.3 million from the date of acquisition through September 30, 2016.

## Pro Forma Information (Unaudited)

The following table summarizes certain supplemental unaudited pro forma financial information which was prepared as if the acquisition of the North American automotive ignition wire business of General Cable Corporation described above had occurred as of January 1, 2015. The unaudited pro forma financial information was prepared for comparative purposes only and does not purport to be indicative of what would have occurred had the acquisition been made at that time, or of results which may occur in the future. Supplemental unaudited pro forma financial information for the acquisition is as follows (in thousands):





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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

|              | Three Months Ended<br>September 30, 2016 |            | Three Months Ended<br>September 30, 2015 |            |
|--------------|--|------------|--|------------|
|              | Reported                                 | Pro Forma  | Reported                                 | Pro Forma  |
| Revenues     | \$ 300,795                               | \$ 300,795 | \$ 270,037                               | \$ 293,696 |
| Net earnings | 20,630                                   | 21,037     | 18,466                                   | 18,707     |

|              | Nine Months Ended<br>September 30, 2016 |            | Nine Months Ended<br>September 30, 2015 |            |
|--------------|---|------------|---|------------|
|              | Reported                                | Pro Forma  | Reported                                | Pro Forma  |
| Revenues     | \$ 828,683                              | \$ 868,014 | \$ 767,008                              | \$ 842,422 |
| Net earnings | 52,078                                  | 53,666     | 40,792                                  | 41,757     |

## 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, including the plant rationalization program and other prior year restructuring programs as of December 31, 2015 and September 30, 2016 and activity for the nine months ended September 30, 2016 consisted of the following (in thousands):

|   | Workforce<br>Reduction | Other Exit<br>Costs | Total    |
|---|------------------------|---------------------|----------|
| Exit activity liability at December 31, 2015  | \$ 270                 | \$ 591              | \$ 861   |
| Restructuring and integration costs:          |                        |                     |          |
| Amounts provided for during 2016              | 2,127                  | —                   | 2,127    |
| Cash payments                                 | (647 )                 | (122 )              | (769 )   |
| Exit activity liability at September 30, 2016 | \$ 1,750               | \$ 469              | \$ 2,219 |

## Plant Rationalization Program

In February 2016, in connection with our ongoing efforts to improve operating efficiencies and reduce costs, we finalized our intention to implement a plant rationalization initiative. As part of the plant rationalization, we plan to relocate certain production activities from our Grapevine, Texas manufacturing facility to facilities in Greenville, South Carolina and Reynosa, Mexico, relocate certain service functions from Grapevine, Texas to our administrative offices in Lewisville, Texas, and close our Grapevine, Texas facility. In addition, certain production activities will be relocated from our Greenville, South Carolina manufacturing facility to our manufacturing facility in Bialystok, Poland. Restructuring and integration expenses expected to be incurred related to the program of approximately \$5 million, consisting of employee severance and relocation of certain machinery and equipment, will be recognized throughout the program. During the nine months ended September 30, 2016, we recognized \$2.1 million of restructuring and integration expenses related to the program. We anticipate that the plant rationalization will be completed by February 2018.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Activity, by segment, for the nine months ended September 30, 2016 related to our plant rationalization program consisted of the following (in thousands):

|   | Engine<br>Management | Temperature<br>Control | Other | Total   |
|---|----------------------|------------------------|-------|---------|
| Exit activity liability at December 31, 2015  | \$ —                 | \$ —                   | \$ —  | \$—     |
| Restructuring and integration costs:          |                      |                        |       |         |
| Amounts provided for during 2016              | 566                  | 1,572                  | —     | 2,138   |
| Cash payments                                 | (520 )               | (121 )                 | —     | (641 )  |
| Exit activity liability at September 30, 2016 | \$ 46                | \$ 1,451               | \$ —  | \$1,497 |

## Prior Year Programs

Liabilities associated with the prior year restructuring and integration programs of \$0.7 million as of September 30, 2016 relate primarily to employee severance and other retiree benefit enhancements to be paid through 2020 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. Restructuring and integration expenses for these programs for the nine months ended September 30, 2016 and 2015 were not material.

## 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 \$229.2 million and \$596.8 million of receivables during the three months and nine months ended September 30, 2016, respectively, and \$206.4 million and \$547 million for the comparable periods in 2015. A charge in the amount of \$6 million and \$14.9 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 nine months ended September 30, 2016, respectively, and \$4.3 million and \$11.2 million for the comparable periods in 2015. If we do not enter into these arrangements or if any of the financial institutions with which we enter into these arrangements were to experience financial difficulties or otherwise terminate these arrangements, our financial condition, results of operations and cash flows could be materially and adversely affected by delays or failures to collect future trade accounts receivable.

## Note 6. Inventories

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

| September<br>30,<br>2016 | December 31,<br>2015 |
|--------------------------|----------------------|
| (In thousands)           |                      |

|                   |            |            |
|-------------------|------------|------------|
| Finished goods    | \$ 190,494 | \$ 186,782 |
| Work-in-process   | 6,190      | 5,456      |
| Raw materials     | 105,914    | 93,555     |
| Total inventories | \$302,598  | \$ 285,793 |

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 7. Acquired Intangible Assets

Acquired identifiable intangible assets consist of the following:

|                                   | September<br>30,<br>2016 | December 31,<br>2015 |
|-----------------------------------|--------------------------|----------------------|
|                                   | (In thousands)           |                      |
| Customer relationships            | \$87,366                 | \$ 48,475            |
| Trademarks and trade names        | 6,800                    | 6,800                |
| Non-compete agreements            | 3,204                    | 970                  |
| Patents                           | 723                      | 723                  |
| Supply agreements                 | 800                      | —                    |
| Leaseholds                        | 160                      | 160                  |
| Total acquired intangible assets  | 99,053                   | 57,128               |
| Less accumulated amortization (1) | (33,805)                 | (29,040)             |
| Net acquired intangible assets    | \$65,248                 | \$ 28,088            |

(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 May 2016, we acquired the North American automotive ignition wire business of General Cable Corporation. Intangible assets acquired in the acquisition of \$42.4 million consists of customer relationships of \$39.4 million that will be amortized on a straight-line basis over the estimated useful life of 15 years; a non-compete agreement of \$2.2 million that will be amortized on a straight-line basis over the estimated useful life of 5 years; and a supply agreement of \$0.8 million that will be amortized on a straight-line basis over the estimated useful life of 1 year.

Total amortization expense for acquired intangible assets was \$2.2 million and \$4.9 million for the three months and nine months ended September 30, 2016, respectively, and \$1.2 million and \$3.7 million for the comparable periods in 2015. Based on the current estimated useful lives assigned to our acquired intangible assets, amortization expense is estimated to be \$2.2 million for the remainder of 2016, \$8 million in 2017, \$7.6 million in 2018, \$6.4 million in 2019 and \$35.8 million in the aggregate for the years 2020 through 2031.

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

Total debt outstanding is summarized as follows:

|                             | September<br>30,<br>2016 | December 31,<br>2015 |
|-----------------------------|--------------------------|----------------------|
|                             | (In thousands)           |                      |
| Revolving credit facilities | \$70,000                 | \$ 47,427            |
| Other                       | 178                      | 78                   |
| Total debt                  | \$70,178                 | \$ 47,505            |

|                            |          |           |
|----------------------------|----------|-----------|
| Current maturities of debt | \$70,044 | \$ 47,443 |
| Long-term debt             | 134      | 62        |
| Total debt                 | \$70,178 | \$ 47,505 |

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Revolving Credit Facility

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

Borrowings under the new credit agreement are secured by substantially all of our assets, including accounts receivable, inventory and certain fixed assets, and those of certain of our subsidiaries. Availability under the credit agreement is based on a formula of eligible accounts receivable, eligible inventory, eligible equipment and eligible fixed assets. After taking into account outstanding borrowings under the credit agreement, there was an additional \$145.1 million available for us to borrow pursuant to the formula at September 30, 2016. Outstanding borrowings under the credit agreement, which are classified as current liabilities, were \$70 million and \$47.4 million at September 30, 2016 and December 31, 2015, respectively. Borrowings under the restated credit agreement have been classified as current liabilities based upon the accounting rules and certain provisions in the agreement.

At September 30, 2016, the weighted average interest rate on our credit agreement was 1.8%, which consisted of \$70 million in direct borrowings. At December 31, 2015, the weighted average interest rate on our credit agreement was 1.7%, which consisted of \$44 million in direct borrowings at 1.6% and an alternative base rate loan of \$3.4 million at 3.8%. During the nine months ended September 30, 2016, our average daily alternative base rate loan balance was \$2.9 million at a weighted average interest rate of 3.8%, compared to our average daily index loan balance of \$3.5 million for the nine months ended September 30, 2015 at a weighted average interest rate of 3.8%, and our average daily alternative base rate/index loan balance of \$4.9 million for the year ended December 31, 2015 at a weighted average interest rate of 3.7%.

At any time that our borrowing availability is less than the greater of either (a) \$25 million, or 10% of the commitments if fixed assets are not included in the borrowing base, or (b) \$31.25 million, or 12.5% of the commitments if fixed assets are included in the borrowing base, the terms of the credit agreement provide for, among other provisions, a financial covenant requiring us, on a consolidated basis, to maintain a fixed charge coverage ratio of 1:1 at the end of each fiscal quarter (rolling four quarters). As of September 30, 2016, we were not subject to these covenants. The credit agreement permits us to pay cash dividends of \$20 million and make stock repurchases of \$20 million in any fiscal year subject to a minimum availability of \$25 million. Provided specific conditions are met, the credit agreement also permits acquisitions, permissible debt financing, capital expenditures, and cash dividend payments and stock repurchases of greater than \$20 million.

The new credit agreement also replaces our Canadian Credit Agreement with GE Canada Finance Holding Company. The new agreement with JPMorgan Chase Bank, N.A. allows for a \$10 million line of credit to Canada as part of the \$250 million available for borrowing.

Deferred Financing Costs

We had deferred financing costs of \$1.4 million and \$1.6 million as of September 30, 2016 and December 31, 2015, respectively. Deferred financing costs are related to our revolving credit facility. Deferred financing costs as of September 30, 2016 are being amortized in the amounts of \$0.1 million for the remainder of 2016, \$0.4 million in 2017, \$0.3 million in 2018, \$0.3 million in 2019 and \$0.3 million in 2020.



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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 (in thousands)

|  | Three Months Ended September 30, 2016             |  |             |
|--|---|--|-------------|
|  | Foreign<br>Currency<br>Translation<br>Adjustments | Unrecognized<br>Pension and<br>Postretirement<br>Benefit Costs<br>(Credit) | Total       |
| Balance at June 30, 2016   | \$ (6,111 )                                       | \$ (120 )  | \$ (6,231 ) |
| Other comprehensive income before reclassifications              | (188 )  | —  | (188 )      |
| Amounts reclassified from accumulated other comprehensive income | —   | 105  | 105         |
| Other comprehensive income, net                                  | (188 )  | 105  | (83 )       |
| Balance at September 30, 2016                                    | \$ (6,299 )                                       | \$ (15 )   | \$ (6,314 ) |

|  | Nine Months Ended September 30, 2016              |  |             |
|--|---|--|-------------|
|  | Foreign<br>Currency<br>Translation<br>Adjustments | Unrecognized<br>Pension and<br>Postretirement<br>Benefit Costs<br>(Credit) | Total       |
| Balance at December 31, 2015                                     | \$ (5,958 )                                       | \$ (516 )  | \$ (6,474 ) |
| Other comprehensive income before reclassifications              | (341 )  | 185  | (156 )      |
| Amounts reclassified from accumulated other comprehensive income | —   | 316  | 316         |
| Other comprehensive income, net                                  | (341 )  | 501  | 160         |
| Balance at September 30, 2016                                    | \$ (6,299 )                                       | \$ (15 )   | \$ (6,314 ) |

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

| Details About Accumulated Other Comprehensive Income Components | Three Months Ended<br>September 30, 2016 | Nine Months Ended<br>September 30, 2016 |
|---|--|---|
| Amortization of postretirement benefit plans:                   |  |   |
| Prior service benefit (1)                                       | \$ (14 )                                 | \$ (41 )                                |
| Unrecognized loss (1)   | 194                                      | 584                                     |
| Total before income tax   | 180                                      | 543                                     |
| Income tax expense  | (75 )                                    | (227 )                                  |
| Total reclassifications for the period                          | \$ 105                                   | \$ 316                                  |

These accumulated other comprehensive income components are included in the computation of net periodic (1) 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.

## Restricted and Performance Stock Grants

In May 2016, our Board of Directors and Shareholders approved the 2016 Omnibus Incentive Plan. The 2016 Omnibus Incentive Plan supersedes the 2006 Omnibus Incentive Plan, which terminated in May 2016. The 2016 Omnibus Incentive Plan is the only remaining plan available to provide stock-based incentive compensation to our employees, directors and other eligible persons.

Under the 2016 Omnibus Incentive Plan, which terminates in May 2026, we are authorized to issue, among other things, shares of restricted and performance-based stock to eligible employees and restricted stock to directors of up to 1,100,000 shares. Shares issued under the plan that are cancelled, forfeited or expire by their terms are eligible to be granted again under the 2016 Omnibus Incentive Plan. Awards previously granted under the 2006 Omnibus Incentive Plan are not affected by the plan's termination, while shares not yet granted under the plan are not available for future issuance.

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

Our restricted and performance-based share activity was as follows for the nine months ended September 30, 2016:

|                              | Shares    | Weighted Average<br>Grant Date Fair<br>Value Per Share |
|------------------------------|-----------|--|
| Balance at December 31, 2015 | 758,550   | \$ 27.19   |
| Granted                      | 7,000     | 32.25  |
| Vested                       | (14,850 ) | 33.19  |
| Forfeited                    | (8,150 )  | 31.60  |

Balance at September 30, 2016 742,550 \$ 27.08

We recorded compensation expense related to restricted shares and performance-based shares of \$3.7 million (\$2.3 million, net of tax) and \$3.6 million (\$2.3 million, net of tax) for the nine months ended September 30, 2016 and 2015, respectively. The unamortized compensation expense related to our restricted and performance-based shares was \$9 million at September 30, 2016, and is expected to be recognized as they vest over a weighted average period of 5.1 years and 0.6 years for employees and directors, respectively.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 11. Employee Benefits

The components of net periodic benefit cost for our postretirement benefit plans for the three months and nine months ended September 30, 2016 and 2015 were as follows (in thousands):

|                                    | Three Months Ended |        | Nine Months Ended |          |
|------------------------------------|--------------------|--------|-------------------|----------|
|                                    | September 30,      |        | September 30,     |          |
| Postretirement benefits            | 2016               | 2015   | 2016              | 2015     |
| Service cost                       | \$ —               | \$ —   | \$ —              | \$ —     |
| Interest cost                      | 4                  | 12     | 10                | 20       |
| Amortization of prior service cost | (14 )              | (27 )  | (41 )             | (85 )    |
| Actuarial net loss                 | 194                | 382    | 584               | 1,144    |
| Net periodic benefit cost          | \$ 184             | \$ 367 | \$ 553            | \$ 1,079 |

For the nine months ended September 30, 2016, we made employee benefit contributions of \$0.7 million related to our postretirement plans. Based on current estimates, we believe we will be required to make approximately \$1 million in contributions for 2016.

We maintain a defined contribution Supplemental Executive Retirement Plan for key employees. Under the plan, these employees may elect to defer a portion of their compensation and, in addition, we may at our discretion make contributions to the plan on behalf of the employees. In March 2016, we made company contributions to the plan of \$0.3 million related to calendar year 2015.

We also maintain a defined benefit unfunded Supplemental Executive Retirement Plan (“SERP”). The SERP, as amended, is a defined benefit plan pursuant to which we will pay supplemental pension benefits to certain key employees upon the attainment of a contractual participant’s payment date based upon the employees’ years of service and compensation. In October 2015, the sole remaining participant in the unfunded SERP reached his applicable payment date and, in connection therewith, received his corresponding lump-sum distribution of \$7.6 million. We recorded no expense related to the plan during the three months and nine months ended September 30, 2016. Net periodic benefit cost of \$0.4 million and \$0.9 million was recorded related to the plan for the three months and nine months ended September 30, 2015.

We also have an Employee Stock Ownership Plan and Trust for employees who are not covered by a collective bargaining agreement. In connection therewith, we maintain an employee benefits trust to which we contribute shares of treasury stock. We are authorized to instruct the trustees to distribute such shares toward the satisfaction of our future obligations under the plan. The shares held in trust are not considered outstanding for purposes of calculating earnings per share until they are committed to be released. The trustees will vote the shares in accordance with their fiduciary duties. During the nine months ended September 30, 2016, we contributed to the trust an additional 59,200 shares from our treasury and released 59,200 shares from the trust leaving 200 shares remaining in the trust as of September 30, 2016.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Note 12. Fair Value Measurements

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

## 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 Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2016                                | 2015      | 2016                               | 2015      |
| <b>Basic Net Earnings Per Common Shares:</b>                    |                                     |           |                                    |           |
| Earnings from continuing operations                             | \$ 21,055                           | \$ 19,194 | \$ 53,573                          | \$ 42,341 |
| Loss from discontinued operations                               | (425 )                              | (728 )    | (1,495 )                           | (1,549 )  |
| Net earnings available to common stockholders                   | \$ 20,630                           | \$ 18,466 | \$ 52,078                          | \$ 40,792 |
| Weighted average common shares outstanding                      | 22,716                              | 22,771    | 22,688                             | 22,866    |
| Earnings from continuing operations per common share            | \$ 0.93                             | \$ 0.84   | \$ 2.36                            | \$ 1.85   |
| Loss from discontinued operations per common share              | (0.02 )                             | (0.03 )   | (0.06 )                            | (0.07 )   |
| Basic net earnings per common share                             | \$ 0.91                             | \$ 0.81   | \$ 2.30                            | \$ 1.78   |
| <b>Diluted Net Earnings Per Common Share:</b>                   |                                     |           |                                    |           |
| Earnings from continuing operations                             | \$ 21,055                           | \$ 19,194 | \$ 53,573                          | \$ 42,341 |
| Loss from discontinued operations                               | (425 )                              | (728 )    | (1,495 )                           | (1,549 )  |
| Net earnings available to common stockholders                   | \$ 20,630                           | \$ 18,466 | \$ 52,078                          | \$ 40,792 |
| Weighted average common shares outstanding                      | 22,716                              | 22,771    | 22,688                             | 22,866    |
| Plus incremental shares from assumed conversions:               |                                     |           |                                    |           |
| Dilutive effect of restricted stock and performance-based stock | 382                                 | 363       | 357                                | 354       |
| Dilutive effect of stock options                                | -                                   | -         | -                                  | -         |
| Weighted average common shares outstanding –Diluted             | 23,098                              | 23,134    | 23,045                             | 23,220    |
| Earnings from continuing operations per common share            | \$ 0.91                             | \$ 0.83   | \$ 2.32                            | \$ 1.82   |
| Loss from discontinued operations per common share              | (0.02 )                             | (0.03 )   | (0.06 )                            | (0.06 )   |
| Diluted net earnings per common share                           | \$ 0.89                             | \$ 0.80   | \$ 2.26                            | \$ 1.76   |

The shares listed below were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the periods presented or because they were excluded under the treasury method (in

thousands):

|   | Three Months Ended |      | Nine Months Ended |      |
|---|--------------------|------|-------------------|------|
|   | September 30,      |      | September 30,     |      |
|   | 2016               | 2015 | 2016              | 2015 |
| Restricted and performance-based shares | 297                | 315  | 326               | 338  |

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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 remanufactures ignition and emission parts, ignition wires, battery cables, fuel system parts and sensors for vehicle systems. Our Temperature Control Segment manufactures and remanufactures air conditioning compressors, air conditioning and heating parts, engine cooling system parts, power window accessories and windshield washer system parts.

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

|                      | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|----------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                      | 2016                                | 2015      | 2016                               | 2015      |
| Net Sales            |                                     |           |                                    |           |
| Engine Management    | \$200,782                           | \$176,379 | \$580,311                          | \$530,442 |
| Temperature Control  | 96,819                              | 90,625    | 241,088                            | 228,432   |
| All Other            | 3,194                               | 3,033     | 7,284                              | 8,134     |
| Consolidated         | \$300,795                           | \$270,037 | \$828,683                          | \$767,008 |
| Intersegment Revenue |                                     |           |                                    |           |
| Engine Management    | \$5,189                             | \$4,381   | \$15,878                           | \$14,434  |
| Temperature Control  | 2,354                               | 2,027     | 6,069                              | 5,396     |
| All Other            | (7,543 )                            | (6,408 )  | (21,947 )                          | (19,830 ) |
| Consolidated         | \$—                                 | \$—       | \$—                                | \$—       |
| Operating Income     |                                     |           |                                    |           |
| Engine Management    | \$29,745                            | \$24,740  | \$84,497                           | \$68,295  |
| Temperature Control  | 9,283                               | 8,964     | 17,097                             | 10,710    |
| All Other            | (5,454 )                            | (3,747 )  | (16,157 )                          | (12,821 ) |
| Consolidated         | \$33,574                            | \$29,957  | \$85,437                           | \$66,184  |

## 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 September 30, 2016, approximately 1,560 cases were outstanding for which we may be responsible for any related liabilities. Since inception in September 2001 through September 30, 2016, the amounts paid for settled claims are approximately \$19.5 million.

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.



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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

The most recent actuarial study was performed as of August 31, 2016. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs and any potential recovery from insurance carriers, ranging from \$31 million to \$47.7 million for the period through 2059. The change from the prior year study was a \$2.3 million decrease for the low end of the range and a \$3.4 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, our historical data and certain assumptions with respect to events that may occur in the future. Based on the information contained in the actuarial study and all other available information considered by us, we have concluded that no amount within the range of settlement payments was more likely than any other and, therefore, in assessing our asbestos liability we compare the low end of the range to our recorded liability to determine if an adjustment is required. Based upon the results of the August 31, 2016 actuarial study, a favorable adjustment to the asbestos liability was not 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. Future legal costs, which are expensed as incurred and reported in loss from discontinued operations in the accompanying statement of operations, are estimated, according to the updated study, to range from \$42.7 million to \$78.6 million for the period through 2059.

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

Other Litigation

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

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

## Warranties

We generally warrant our products against certain manufacturing and other defects. These product warranties are provided for specific periods of time of the product depending on the nature of the product. As of September 30, 2016 and 2015, we have accrued \$28.5 million and \$25.9 million, respectively, for estimated product warranty claims included in accrued customer returns. The accrued product warranty costs are based primarily on historical experience of actual warranty claims.

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

|  | Three Months Ended |          | Nine Months Ended |          |
|--|--------------------|----------|-------------------|----------|
|  | September 30,      |          | September 30,     |          |
|  | 2016               | 2015     | 2016              | 2015     |
| Balance, beginning of period               | \$26,946           | \$25,148 | \$23,395          | \$19,328 |
| Liabilities accrued for current year sales | 30,479             | 25,626   | 78,478            | 72,613   |
| Settlements of warranty claims             | (28,921)           | (24,919) | (73,369)          | (66,086) |
| Balance, end of period                     | \$28,504           | \$25,855 | \$28,504          | \$25,855 |

## Note 16. Subsequent Event

In October 2016, in connection with our integration of the acquired North American automotive wire business of General Cable Corporation in May 2016, we finalized our intention to close the acquired manufacturing facility in Nogales, Mexico. As part of the integration, we plan to relocate production activities currently performed in our Nogales, Mexico facility to our facility in Reynosa, Mexico. One-time costs of approximately \$3.3 million are expected to be incurred in 2016 and 2017 consisting of restructuring and integration expenses of approximately \$2.8 million related to employee severance, relocation of certain machinery and equipment, and lease termination fees; and capital expenditures of approximately \$0.5 million. Substantially all of the one-time costs are anticipated to result in future cash expenditures. We anticipate that the integration will be completed within 12 to 18 months.

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

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements in this Report are indicated by words such as “anticipates,” “expects,” “believes,” “intends,” “plans,” “estimates,” “projects,” “strategies” and similar expressions. These statements represent our expectations based on current information and assumptions and are inherently subject to risks and uncertainties. Our actual results could differ materially from those which are anticipated or projected as a result of certain risks and uncertainties, including, but not limited to, changes in business relationships with our major customers and in the timing, size and continuation of our customers’ programs; changes in our receivables factoring arrangements; the ability of our customers to achieve their projected sales; competitive product and pricing pressures; increases in production or material costs that cannot be recouped in product pricing; the performance of the aftermarket, heavy duty, industrial equipment and original equipment service markets; changes in the product mix and distribution channel mix; economic and market conditions; successful integration of acquired businesses; our ability to achieve benefits from our cost savings initiatives; product liability and environmental matters (including, without limitation, those related to asbestos-related contingent liabilities and remediation costs at certain properties); as well as other risks and uncertainties, such as those described under Risk Factors, Quantitative and Qualitative Disclosures About Market Risk and those detailed herein and from time to time in the filings of the Company with the SEC. Forward-looking statements are made only as of the date hereof, and the Company undertakes no obligation to update or revise the forward-looking statements, whether as a result of new information, future events or otherwise. In addition, historical information should not be considered as an indicator of future performance. The following discussion should be read in conjunction with the unaudited consolidated financial statements, including the notes thereto, included elsewhere in this Report.

## Business Overview

We are a leading independent manufacturer and distributor of replacement parts for motor vehicles in the automotive aftermarket industry with a complementary focus on heavy duty, industrial equipment and the original equipment 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 and remanufactures ignition and emission parts, ignition wires, battery cables, fuel system parts and sensors for vehicle systems. Our Temperature Control Segment manufactures and remanufactures air conditioning compressors, air conditioning and heating parts, engine cooling system parts, power window accessories, and windshield washer system parts.

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



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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.

**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 both 2014 and 2013, may lessen the demand for our Temperature Control products, while a warm summer, as we experienced in 2015 and are experiencing in 2016, may increase such demand. As a result of this seasonality and variability in demand of our Temperature Control products, our working capital requirements typically peak near the end of the second quarter, as the inventory build up of air conditioning products is converted to sales and payments on the receivables associated with such sales have yet to be received. During this period, our working capital requirements are typically funded by borrowing from our revolving credit facility.

**Inventory Management.** We face inventory management issues as a result of warranty and overstock returns. Many of our products carry a warranty ranging from a 90-day limited warranty to a lifetime limited warranty, which generally covers defects in materials or workmanship and failure to meet industry published specifications and/or the result of installation error. In addition to warranty returns, we also permit our customers to return new, undamaged products to us within customer-specific limits (which are generally limited to a specified percentage of their annual purchases from us) in the event that they have overstocked their inventories. 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 installation 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 in accordance with approved procedures.

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



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## Interim Results of Operations:

## Comparison of the Three Months Ended September 30, 2016 to the Three Months Ended September 30, 2015

Sales. Consolidated net sales for the three months ended September 30, 2016 were \$300.8 million, an increase of \$30.8 million, or 11.4%, compared to \$270 million in the same period of 2015. Consolidated net sales increased due to the higher net sales achieved by both our Engine Management and Temperature Control Segments.

The following table summarizes consolidated net sales by segment and by major product group within each segment for the three months ended September 30, 2016 and 2015 (in thousands):

|  | Three Months Ended September 30, |            |
|--|----------------------------------|------------|
|  | 2016                             | 2015       |
| Engine Management:                       |                                  |            |
| Ignition, Emission and Fuel System Parts | \$ 157,108                       | \$ 153,368 |
| Wire and Cable                           | 43,674                           | 23,011     |
| Total Engine Management                  | 200,782                          | 176,379    |
| Temperature Control:                     |                                  |            |
| Compressors                              | 53,941                           | 45,015     |
| Other Climate Control Parts              | 42,878                           | 45,610     |
| Total Temperature Control                | 96,819                           | 90,625     |
| All Other                                | 3,194                            | 3,033      |
| Total                                    | \$ 300,795                       | \$ 270,037 |

Engine Management's net sales increased \$24.4 million, or 13.8%, to \$200.8 million for the three months ended September 30, 2016. Net sales in the ignition, emissions and fuel systems parts product group for the three months ended September 30, 2016 were \$157.1 million, an increase of \$3.7 million, or 2.4%, compared to \$153.4 million in the same period of 2015. Net sales in the wire and cable product group for the three months ended September 30, 2016 were \$43.7 million, an increase of \$20.7 million, or 89.8%, compared to \$23 million in the three months ended September 30, 2015. In May 2016, we acquired the North American automotive ignition wire business of General Cable Corporation. Incremental net sales from the acquisition of \$22.8 million were included in net sales of the wire and cable product group for the three months ended September 30, 2016. Excluding the incremental sales from the acquisition, Engine Management net sales increased \$1.6 million, or 0.9%, compared to the same period of 2015.

Temperature Control's net sales increased \$6.2 million, or 6.8%, to \$96.8 million for the three months ended September 30, 2016. Net sales in the compressors product group for the three months ended September 30, 2016 were \$53.9 million, an increase of \$8.9 million, or 19.8%, compared to \$45 million in the same period of 2015. Net sales in the other climate control parts product group for the three months ended September 30, 2016 were \$42.9 million, a decrease of \$2.7 million, or 6%, compared to \$45.6 million in the three months ended September 30, 2015. 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.

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Gross Margins. Gross margins, as a percentage of consolidated net sales, increased to 31.8% in the third quarter of 2016, compared to 30.2% in the third quarter of 2015. The following table summarizes gross margins by segment for the three months ended September 30, 2016 and 2015, respectively (in thousands):

| Three Months Ended<br>September 30,<br><u>2016</u> | Engine<br>Management | Temperature<br>Control | Other   | Total     |
|--|----------------------|------------------------|---------|-----------|
| Net sales  | \$ 200,782           | \$ 96,819              | \$3,194 | \$300,795 |
| Gross margins                                      | 66,849               | 25,773                 | 3,022   | 95,644    |
| Gross margin percentage                            | 33.3 %               | 26.6 %                 | —       | 31.8 %    |

2015

|                         |            |           |         |           |
|-------------------------|------------|-----------|---------|-----------|
| Net sales               | \$ 176,379 | \$ 90,625 | \$3,033 | \$270,037 |
| Gross margins           | 55,258     | 23,308    | 2,987   | 81,553    |
| Gross margin percentage | 31.3 %     | 25.7 %    | —       | 30.2 %    |

Compared to the third quarter of 2015, gross margins at Engine Management increased 2 percentage points from 31.3% to 33.3%, and gross margins at Temperature Control increased 0.9 percentage points from 25.7% to 26.6%. The gross margin percentage increase in Engine Management compared to the prior year was the result of the year-over-year increase in production volume improving overhead absorption, and low cost sourcing. The gross margin percentage increase in Temperature Control compared to the prior year resulted primarily from the year-over-year increase in production volumes generating favorable overhead absorption.

Selling, General and Administrative Expenses. Selling, general and administrative expenses (“SG&A”) increased to \$61.3 million, or 20.4% of consolidated net sales, in the third quarter of 2016, as compared to \$51.9 million, or 19.2% of consolidated net sales, in the third quarter of 2015. The \$9.4 million increase in SG&A expenses as compared to the third quarter of 2015 is principally due to (1) higher selling and marketing costs, higher distribution expenses, and higher costs incurred in our accounts receivable factoring program, all associated with the increased sales volumes; and (2) incremental expenses from our acquisition of the North American automotive ignition wire business of General Cable Corporation, including amortization of intangible assets acquired.

Restructuring and Integration Expenses (Income). Restructuring and integration expenses for the third quarter of 2016 were \$1.1 million compared to restructuring and integration income of \$0.08 million for the third quarter of 2015. The \$1.2 million year-over-year increase in restructuring and integration expenses reflects the impact of the plant rationalization program that commenced in February 2016.

Other Income, net. Other income, net was \$0.3 million in the third quarter of 2016 compared to \$0.2 million in the third quarter of 2015. During 2016 and 2015, we recognized \$0.3 million of deferred gain related to the sale-leaseback of our Long Island City, New York facility.

Operating Income. Operating income was \$33.6 million in the third quarter of 2016, compared to \$30 million in the third quarter of 2015. The increase in operating income in the third quarter of 2016 compared to the third quarter of 2015 reflects the impact of higher consolidated net sales and higher gross margins as a percentage of consolidated net sales offset, in part, by higher SG&A expenses and higher restructuring and integration expenses.

Other Non-Operating Income (Expense), Net. Other non-operating income, net was \$0.2 million in the third quarter of 2016, compared to other non-operating expense, net of \$0.5 million in the third quarter of 2015. During the third quarter of 2016, other non-operating income, net consisted primarily of equity income from our joint ventures of \$0.3 million offset, in part, by foreign currency losses of \$0.1 million. Other non-operating expense, net during the third quarter of 2015 consisted primarily of equity losses from our joint ventures of \$0.4 million and foreign currency losses



of \$0.1 million.

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**Interest Expense.** Interest expense increased to \$0.5 million in the third quarter of 2016 compared to \$0.3 million in the third quarter of 2015, as the year-over-year increase in average outstanding borrowings more than offset the year-over-year decline in average interest rates. The year-over-year increase in our average outstanding borrowings resulted primarily from our May 2016 acquisition of the North American automotive ignition wire business of General Cable Corporation for approximately \$67.5 million which was funded by our revolving credit facility.

**Income Tax Provision.** The income tax provision in the third quarter of 2016 was \$12.2 million at an effective tax rate of 36.7% compared to \$9.9 million at an effective tax rate of 34% for the same period in 2015. The higher year-over-year effective tax rate is the result of a change in the mix of pre-tax income from lower foreign tax rate jurisdictions to the U.S., and the year-over-year increase in state and local effective tax rates.

**Loss from Discontinued Operations.** Loss from discontinued operations, net of income tax, reflects information contained in the most recent actuarial studies performed as of August 31, 2016 and 2015, other information available and considered by us, and legal expenses associated with our asbestos-related liability. During the third quarter of 2016 and 2015, we recorded a loss of \$0.4 million and \$0.7 million from discontinued operations, respectively. We perform annual actuarial studies during the third quarter of each year. Based upon the actuarial studies performed as of August 31, 2016 and 2015, a favorable adjustment to the asbestos liability was not recorded in our consolidated financial statements in each of the third quarters of 2016 and 2015 as the difference between the low end of the range in each of the actuarial studies and our recorded liability was not material. As discussed more fully in Note 15 in the notes to our consolidated financial statements (unaudited), we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

#### Comparison of the Nine Months Ended September 30, 2016 to the Nine Months Ended September 30, 2015

**Sales.** Consolidated net sales for the nine months ended September 30, 2016 were \$828.7 million, an increase of \$61.7 million, or 8%, compared to \$767 million in the same period of 2015. Consolidated net sales increased due to the higher results achieved by both our Engine Management and Temperature Control Segments.

The following table summarizes consolidated net sales by segment and by major product group within each segment for the nine months ended September 30, 2016 and 2015 (in thousands):

|  | Nine Months Ended September 30, |            |
|--|---------------------------------|------------|
|  | 2016                            | 2015       |
| Engine Management:                       |                                 |            |
| Ignition, Emission and Fuel System Parts | \$ 477,242                      | \$ 452,547 |
| Wire and Cable                           | 103,069                         | 77,895     |
| Total Engine Management                  | 580,311                         | 530,442    |
| Temperature Control:                     |                                 |            |
| Compressors                              | 130,941                         | 115,318    |
| Other Climate Control Parts              | 110,147                         | 113,114    |
| Total Temperature Control                | 241,088                         | 228,432    |
| All Other                                | 7,284                           | 8,134      |
| Total                                    | \$ 828,683                      | \$ 767,008 |

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Engine Management's net sales increased \$49.9 million, or 9.4%, to \$580.3 million for the first nine months of 2016. Net sales in the ignition, emissions and fuel systems parts product group for the nine months ended September 30, 2016 were \$477.2 million, an increase of \$24.7 million, or 5.5%, compared to \$452.5 million in the same period of 2015. Net sales in the wire and cable product group for the nine months ended September 30, 2016 were \$103.1 million, an increase of \$25.2 million, or 32.3%, compared to \$77.9 million in the first nine months of 2015. In May 2016, we acquired the North American automotive ignition wire business of General Cable Corporation. Incremental net sales of \$31.3 million were included in net sales of the wire and cable product group from the date of acquisition through September 30, 2016. Excluding the incremental sales from the acquisition, Engine Management net sales increased \$18.6 million, or 3.5%, compared to the first nine months of 2015 in line with our low-to-mid single digit sales forecast.

Temperature Control's net sales increased \$12.6 million, or 5.5%, to \$241.1 million for the first nine months of 2016. Net sales in the compressors product group for the nine months ended September 30, 2016 were \$130.9 million, an increase of \$15.6 million, or 13.5%, compared to \$115.3 million in the same period of 2015. Net sales in the other climate control parts product group for the nine months ended September 30, 2016 were \$110.1 million, a decrease of \$3 million, or 2.6%, compared to \$113.1 million in the first nine months of 2015. 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, increased to 30.9% in the first nine months of 2016, compared to 28.4% during the same period in 2015. The following table summarizes gross margins by segment for the nine months ended September 30, 2016 and 2015 (in thousands):

| Nine Months Ended<br>September 30,<br><u>2016</u> | Engine<br>Management | Temperature<br>Control | Other   | Total     |
|---|----------------------|------------------------|---------|-----------|
| Net sales   | \$ 580,311           | \$ 241,088             | \$7,284 | \$828,683 |
| Gross margins                                     | 187,956              | 60,447                 | 7,313   | 255,716   |
| Gross margin percentage                           | 32.4                 | % 25.1                 | % —     | 30.9 %    |
| <u>2015</u>                                       |                      |                        |         |           |
| Net sales   | \$ 530,442           | \$ 228,432             | \$8,134 | \$767,008 |
| Gross margins                                     | 159,227              | 50,438                 | 8,537   | 218,202   |
| Gross margin percentage                           | 30                   | % 22.1                 | % —     | 28.4 %    |

Compared to the first nine months of 2015, gross margins at Engine Management increased 2.4 percentage points from 30% to 32.4%, and gross margins at Temperature Control increased 3 percentage points from 22.1% to 25.1%. The gross margin percentage increase in Engine Management compared to the prior year was primarily the result of the year-over-year increase in production volume and the impact of one-time costs incurred in the prior year's first nine months to improve our diesel manufacturing production processes. The gross margin percentage increase in Temperature Control compared to the prior year resulted primarily from year-over-year increased production volumes, and unabsorbed manufacturing overheads charged in the prior year's first nine months results which negatively impacted the first nine months 2015 gross margins.

Selling, General and Administrative Expenses. SG&A expenses increased to \$169 million, or 20.4% of consolidated net sales, in the nine months ended September 30, 2016, as compared to \$152.8 million, or 19.9% of consolidated net sales, in the same period of 2015. The \$16.2 million increase in SG&A expenses as compared to the first nine months of 2015 is principally due to (1) higher selling and marketing costs, higher distribution expenses, and higher costs incurred in our accounts receivable factoring program, all associated with increased sales volumes; and (2) incremental expenses from our acquisition of the North American automotive ignition wire business of General Cable

Corporation, including amortization of intangible assets acquired.

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**Restructuring and Integration Expenses (Income).** Restructuring and integration expenses for the nine months ended September 30, 2016 were \$2.1 million compared to restructuring and integration income of \$0.05 million for the nine months ended September 30, 2015. The \$2.2 million year-over-year increase in restructuring and integration expenses reflects the impact of the plant rationalization program that commenced in February 2016.

**Other Income, Net.** Other income, net was \$0.9 million in the nine months ended September 30, 2016 compared to \$0.8 million in the first nine months of 2015. During 2016 and 2015, we recognized \$0.8 million of deferred gain related to the sale-leaseback of our Long Island City, New York facility.

**Operating Income.** Operating income was \$85.4 million in the first nine months of 2016, compared to \$66.2 million for the same period in 2015. The year-over-year increase in operating income of \$19.2 million is the result of higher consolidated net sales and higher gross margins as a percentage of consolidated net sales offset, in part, by higher SG&A expenses and higher restructuring and integration expenses.

**Other Non-Operating Income, Net.** Other non-operating income, net was \$0.8 million in the first nine months of 2016, compared to other non-operating income, net of \$0.2 million in the first nine months of 2015. The year-over-year increase in other non-operating income, net resulted primarily from the increase in equity income from our joint ventures, higher interest and dividend income, and the favorable impact of changes in foreign currency exchange rates.

**Interest Expense.** Interest expense was \$1.2 million in each of the first nine months of 2016 and 2015. The impact of the year-over-year increase in average outstanding borrowings during the first nine months of 2016 when compared to the same period in 2015 was offset by the year-over-year decline in average interest rates. The year-over-year increase in our average outstanding borrowings resulted primarily from our May 2016 acquisition of the North American automotive ignition wire business of General Cable Corporation for approximately \$67.5 million which was funded by our revolving credit facility.

**Income Tax Provision.** The income tax provision for the nine months ended September 30, 2016 was \$31.5 million at an effective tax rate of 37%, compared to \$22.8 million at an effective tax rate of 35% for the same period in 2015. The higher year-over-year effective tax rate is the result of a change in the mix of pre-tax income from lower foreign tax rate jurisdictions to the U.S., and the year-over-year increase in state and local effective tax rates.

**Loss from Discontinued Operations.** Loss from discontinued operations, net of income tax, reflects information contained in the most recent actuarial studies performed as of August 31, 2016 and 2015, other information available and considered by us, and legal expenses associated with our asbestos-related liability. During the nine months ended September 30, 2016 and 2015, we recorded a loss of \$1.5 million and \$1.5 million from discontinued operations, respectively. We perform annual actuarial studies during the third quarter of each year. Based upon the actuarial studies performed as of August 31, 2016 and 2015, a favorable adjustment to the asbestos liability was not recorded in our consolidated financial statements in each of the third quarters of 2016 and 2015 as the difference between the low end of the range in each of the actuarial studies and our recorded liability was not material. As discussed more fully in Note 15 in the notes to our consolidated financial statements (unaudited), we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

**Restructuring and Integration Costs**

For a detailed discussion on the restructuring and integration costs, see Note 4, "Restructuring and Integration Costs," of the notes to our consolidated financial statements (unaudited).

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## Liquidity and Capital Resources

Operating Activities. During the first nine months of 2016, cash provided by operating activities was \$83 million compared to \$72.8 million in the same period of 2015. The year-over-year increase in operating cash flow is primarily the result of the increase in net earnings, a larger year-over-year increase in sundry payables and accrued expenses, and the larger year-over-year decrease in prepaid expenses and other current assets in 2016 compared to the first nine months of 2015 offset, in part, by the larger year-over-year increase in accounts receivable and the increase in inventories compared to a year-over-year decrease in inventories in 2015.

Net earnings during the first nine months of 2016 were \$52.1 million compared to \$40.8 million in the first nine months of 2015. During the first nine months of 2016, (1) the increase in sundry payables and accrued expenses was \$31 million compared to the year-over-year increase in sundry payables and accrues expenses of \$21.7 million in 2015; (2) the decrease in prepaid expenses and other current assets was \$5.4 million compared to the year-over-year a decrease in prepaid expenses and current assets of \$2.4 million in 2015; (3) the increase in receivables was \$35.2 million compared to the year-over-year increase in receivables of \$25.1 million in 2015; and (4) the increase in inventories was \$7.4 million compared to the year-over-year decrease in inventories of \$4.8 million in 2015. The increase in accounts receivable and inventories is the result of the impact of our May 2016 acquisition of the North American automotive ignition wire business of General Cable Corporation. We continue to actively manage our working capital to maximize our operating cash flow.

Investing Activities. Cash used in investing activities was \$82.3 million in the first nine months of 2016, as compared to \$14.6 million in the first nine months of 2015. Investing activities during the first nine months of 2016 consisted of (1) our acquisition of certain assets and the assumption of certain liabilities of General Cable Corporation's automotive ignition wire business in North America as well as 100% of the equity interests of a General Cable subsidiary in Nogales, Mexico for \$67.3 million, net of cash acquired and (2) capital expenditures of \$15.2 million. Investing activities during the first nine months of 2015 consisted of \$14.6 million of capital expenditures.

Financing Activities. Cash provided by financing activities was \$11.5 million in the first nine months of 2016, compared to cash used in financing activities of \$57.9 million in the same period of 2015. During the first nine months of 2016, borrowings under our revolving credit facility, along with cash provided by operating activities, were used to fund the acquisition of the North American automotive ignition business of General Cable Corporation, purchase shares of our common stock, pay dividends and fund capital expenditures. During the first nine months of 2015, the excess of cash provided by operations over cash used in investing activities was used to pay down borrowings under our revolving credit facility, purchase shares of our common stock and pay dividends. During the first nine months of 2016, we borrowed an additional \$22.6 million under our revolving credit facility as compared to a reduction in borrowings under the facility of \$32.1 million in 2015, we repurchased 10,135 shares of our common stock for \$0.4 million as compared to the repurchase of 439,802 shares of our common stock for \$15.5 million in 2015, and we paid dividends of \$11.6 million compared to \$10.3 million in the comparable period during the prior year. In January 2016, our Board of Directors voted to increase our quarterly dividend from \$0.15 per share in 2015 to \$0.17 per share in 2016.

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



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Borrowings under the new credit agreement are secured by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. Availability under the credit agreement is based on a formula of eligible accounts receivable, eligible inventory, eligible equipment and eligible fixed assets. After taking into account outstanding borrowings under the credit agreement, there was an additional \$145.1 million available for us to borrow pursuant to the formula at September 30, 2016. Outstanding borrowings under the credit agreement which are classified as current liabilities, were \$70 million and \$47.4 million at September 30, 2016 and December 31, 2015, respectively. Borrowings under the restated credit agreement have been classified as current liabilities based upon accounting rules and certain provisions in the agreement.

At September 30, 2016, the weighted average interest rate on our credit agreement was 1.8%, which consisted of \$70 million in direct borrowings. At December 31, 2015, the weighted average interest rate on our credit agreement was 1.7%, which consisted of \$44 million in direct borrowings at 1.6% and an alternative base rate loan of \$3.4 million at 3.8%. During the nine months ended September 30, 2016, our average daily alternative base rate loan balance was \$2.9 million at a weighted average interest rate of 3.8%, compared to our average daily index loan balance of \$3.5 million for the nine months ended September 30, 2015 at a weighted average interest rate of 3.8%, and our average daily alternative base rate/index loan balance of \$4.9 million for the year ended December 31, 2015 at a weighted average interest rate of 3.7%.

At any time that our borrowing availability is less than the greater of either (a) \$25 million, or 10% of the commitments if fixed assets are not included in the borrowing base, or (b) \$31.25 million, or 12.5% of the commitments if fixed assets are included in the borrowing base, the terms of the credit agreement provide for, among other provisions, a financial covenant requiring us, on a consolidated basis, to maintain a fixed charge coverage ratio of 1:1 at the end of each fiscal quarter (rolling four quarters). As of September 30, 2016, we were not subject to these covenants. The credit agreement permits us to pay cash dividends of \$20 million and make stock repurchases of \$20 million in any fiscal year subject to a minimum availability of \$25 million. Provided specific conditions are met, the credit agreement also permits acquisitions, permissible debt financing, capital expenditures, and cash dividend payments and stock repurchases of greater than \$20 million.

The new credit agreement also replaces our Canadian Credit Agreement with GE Canada Finance Holding Company. The new agreement with JPMorgan Chase Bank, N.A. allows for a \$10 million line of credit to Canada as part of the \$250 million available for borrowing.

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 \$229.2 million and \$596.8 million of receivables during the three months and nine months ended September 30, 2016, respectively, and \$206.4 million and \$547 million of receivables for the comparable periods in 2015. A charge in the amount of \$6 million and \$14.9 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 nine months ended September 30, 2016, respectively, and \$4.3 million and \$11.2 million for the comparable periods in 2015. 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 2016, in connection with our ongoing efforts to improve operating efficiencies and reduce costs, we finalized our intention to implement a plant rationalization initiative. As part of the plant rationalization, we plan to relocate certain production activities from our Grapevine, Texas manufacturing facility to facilities in Greenville, South Carolina and Reynosa, Mexico, relocate certain service functions from Grapevine, Texas to our administrative offices in Lewisville, Texas, and close our Grapevine, Texas facility. In addition, certain production activities will be relocated from our Greenville, South Carolina manufacturing facility to our manufacturing facility in Bialystok, Poland. One-time plant rationalization costs of approximately \$9 million are expected to be incurred in 2016 and 2017 consisting of restructuring and integration expenses of approximately \$5 million related to employee severance and relocation of certain machinery and equipment; capital expenditures of approximately \$2.6 million; and temporary incremental operating expenses of approximately \$1.4 million. Substantially all of the one-time plant rationalization costs are expected to result in future cash expenditures and will be recognized throughout the program. During the three months and nine months ended September 30, 2016, we recognized \$1.1 million and \$2.1 million, respectively, of restructuring and integration expenses related to the program. We anticipate that the plant rationalization will be completed by February 2018.

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, 2015.

The following table summarizes our contractual commitments as of September 30, 2016 and expiration dates of commitments through 2025 (a) (b):

| (In thousands)  | 2016    | 2017    | 2018    | 2019    | 2020    | 2021-   | Total    |
|---|---------|---------|---------|---------|---------|---------|----------|
| Lease obligations   | \$1,931 | \$6,611 | \$4,754 | \$2,839 | \$2,303 | \$6,269 | \$24,707 |
| Postretirement benefits                                     | 642     | 63      | 59      | 54      | 50      | 181     | 1,049    |
| Severance payments related to restructuring and integration | 161     | 1,100   | 434     | 47      | 8       | —       | 1,750    |
| Total commitments   | \$2,734 | \$7,774 | \$5,247 | \$2,940 | \$2,361 | \$6,450 | \$27,506 |

Indebtedness under our revolving credit facilities is not included in the table above as it is reported as a current (a) liability in our consolidated balance sheets. As of September 30, 2016, amounts outstanding under our revolving credit facilities were \$70 million.

We anticipate a total charge of approximately \$3.4 million to be recorded related to the plant rationalization (b) program initiated in February 2016. The plant rationalization program is expected to be completed by February 2018.

### Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout "Management's Discussion and Analysis of Financial Condition and Results of Operations," where such

policies affect our reported and expected financial results. There have been no material changes to our critical accounting policies and estimates from the information provided in Note 1 of the notes to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2015. 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 certain of our sales of remanufactured products, we also charge our customers a deposit for the return of a used core component which we can use in our future remanufacturing activities. Such deposit is not recognized as revenue 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 September 30, 2016, the allowance for sales returns was \$46.4 million.

Similarly, we must make estimates of the uncollectability of our accounts receivable. We specifically analyze accounts receivable and analyze historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. In January 2016, one of our customers filed a petition for bankruptcy. In connection with the bankruptcy filing, we evaluated our potential risk and exposure, and estimated our anticipated recovery as related to our outstanding accounts receivable balance from the customer. As a result of our evaluations, we recorded a net \$3.5 million pre-tax charge during the year ended December 31, 2015, and an additional net \$0.8 million pre-tax charge during the nine months ended September 30, 2016, which resulted in the write-off of our entire accounts receivable balance from the customer as of September 30, 2016. At September 30, 2016, the allowance for doubtful accounts and for discounts was \$4.6 million.



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

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

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

The valuation allowance of \$0.4 million as of September 30, 2016 is intended to provide for the uncertainty regarding the ultimate realization of our U.S. foreign tax credit carryovers and foreign net operating loss carryovers. The assessment of the adequacy of our valuation allowance is based on our estimates of taxable income in these jurisdictions and the period over which our deferred tax assets will be recoverable.

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

In accordance with generally accepted accounting practices, we recognize in our financial statements only those tax positions that meet the more-likely-than-not-recognition threshold. We establish tax reserves for uncertain tax positions that do not meet this threshold. As of September 30, 2016, we do not believe there is a need to establish a liability for uncertain tax positions. 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.

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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.

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

There are inherent assumptions and estimates used in developing future cash flows requiring our judgment in applying these assumptions and estimates to the analysis of identifiable intangibles and long lived asset impairment including projecting revenues, interest rates, tax rates and the cost of capital. Many of the factors used in assessing fair value are outside our control and it is reasonably likely that assumptions and estimates will change in future periods. These changes can result in future impairments. In the event our planning assumptions were modified resulting in impairment to our assets, we would be required to include an expense in our statement of operations, which could materially impact our business, financial condition and results of operations.

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

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

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, 2016 estimated an undiscounted liability for settlement payments, excluding legal costs and any potential recovery from insurance carriers, ranging from \$31 million to \$47.7 million for the period through 2059. 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, 2016 actuarial study, a favorable adjustment to the asbestos liability was not 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, future legal costs, which are expensed as incurred and reported in loss from discontinued operations in the accompanying statement of operations, are estimated to range from \$42.7 million to \$78.6 million for the period through 2059. We will continue to perform an annual actuarial analysis during the third quarter of each year for the foreseeable future. Based on this analysis and all other available information, we will continue to reassess the recorded liability and, if deemed necessary, record an adjustment to the reserve, which will be reflected as a loss or gain from discontinued operations.

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

## Recently Issued Accounting Pronouncements

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

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

### Quantitative and Qualitative Disclosure about Market Risk

We are exposed to market risk, primarily related to foreign currency exchange and interest rates. These exposures are actively monitored by management. Our exposure to foreign exchange rate risk is due to certain costs, revenues and borrowings being denominated in currencies other than one of our subsidiary's functional currency. Similarly, we are exposed to market risk as the result of changes in interest rates, which may affect the cost of our financing. It is our policy and practice to use derivative financial instruments only to the extent necessary to manage exposures. We do not hold or issue derivative financial instruments for trading or speculative purposes. As of September 30, 2016, we do not have any derivative financial instruments.

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Exchange Rate Risk

We have exchange rate exposure, primarily, with respect to the Canadian Dollar, the Euro, the British Pound, the Polish Zloty, the Mexican Peso, the Taiwan Dollar, the Chinese Yuan Renminbi and the Hong Kong Dollar. As of September 30, 2016 and December 31, 2015, our monetary assets and liabilities which are subject to this exposure are immaterial, therefore the potential immediate loss to us that would result from a hypothetical 10% change in foreign currency exchange rates would not be expected to have a material impact on our earnings or cash flows. This sensitivity analysis assumes an unfavorable 10% fluctuation in the exchange rates affecting the foreign currencies in which monetary assets and liabilities are denominated and does not take into account the incremental effect of such a change on our foreign currency denominated revenues.

Interest Rate Risk

We manage our exposure to interest rate risk through the proportion of fixed rate debt and variable rate debt in our debt portfolio. To manage a portion of our exposure to interest rate changes, we have in the past entered into interest rate swap agreements. We invest our excess cash in highly liquid short-term investments. Substantially all of our debt is variable rate debt as of September 30, 2016 and December 31, 2015.

In addition, from time to time, we sell undivided interests in certain of our receivables to financial institutions. We enter these agreements at our discretion when we determine that the cost of factoring is less than the cost of servicing our receivables with existing debt. During the three months and nine months ended September 30, 2016, we sold \$229.2 million and \$596.8 million of receivables, respectively. Depending upon the level of sales of receivables pursuant these agreements, the effect of a hypothetical, instantaneous and unfavorable change of 100 basis points in the margin rate may have an approximate \$2.3 million and \$6 million negative impact on our earnings or cash flows during the three months and nine months ended September 30, 2016, respectively. The charge related to the sale of receivables is included in selling, general and administrative expenses in our consolidated statements of operations.

Other than the aforementioned, there have been no significant changes to the information presented in Item 7A (Market Risk) of our Annual Report on Form 10-K for the year ended December 31, 2015.

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.

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(b) Changes in Internal Control Over Financial Reporting.

During the quarter ended September 30, 2016, we have not made any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this Item is incorporated herein by reference to the information set forth in Item 1, "Consolidated Financial Statements" of this Report under the captions "Asbestos" and "Other Litigation" appearing in Note 15, "Commitments and Contingencies," of the notes to our consolidated financial statements (unaudited).

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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: October 28, 2016 /s/ James J. Burke

James J. Burke  
Executive 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

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- 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.”