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STANDARD MOTOR PRODUCTS INC  
Form 10-Q  
August 06, 2008

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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008

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 11-1362020  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

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

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

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

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an  
accelerated filer, 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. (Check one):

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

Indicate by check mark whether the registrant is a shell company  
(as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of the close of business on July 31, 2008, there were 18,694,123 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

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(In thousands, except share and per share data)	Three Months Ended June 30,		Si
	2008	2007	
	(Unaudited)		
Net sales .....	\$ 215,343	\$ 216,950	\$ 423
Cost of sales .....	166,714	160,261	323
Gross profit .....	48,629	56,689	99
Selling, general and administrative expenses .....	42,724	43,324	86
Restructuring and integration expenses .....	1,376	559	4
Operating income .....	4,529	12,806	8
Other income, net .....	10	779	20
Interest expense .....	3,388	4,795	7
Earnings from continuing operations before taxes ...	1,151	8,790	21
Provision for income tax .....	1,923	3,134	9
Earnings (loss) from continuing operations .....	(772)	5,656	12
Loss from discontinued operations, net of income taxes	(323)	(279)	
Net earnings (loss) .....	\$ (1,095)	\$ 5,377	\$ 11
Per share data:			
Net earnings (loss) per common share - Basic:			
Earnings (loss) from continuing operations .....	\$ (0.04)	\$ 0.30	\$
Discontinued operation .....	(0.02)	(0.01)	(
Net earnings (loss) per common share - Basic .....	\$ (0.06)	\$ 0.29	\$
Net earnings (loss) per common share - Diluted:			
Earnings (loss) from continuing operations .....	\$ (0.04)	\$ 0.30	\$
Discontinued operation .....	(0.02)	(0.02)	(
Net earnings (loss) per common share - Diluted .....	\$ (0.06)	\$ 0.28	\$
Average number of common shares .....	18,332,273	18,781,388	18,319
Average number of common shares and dilutive common shares .....	18,384,840	18,940,962	21,157

See accompanying notes to consolidated financial statements.

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## CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)	June 30, 2008	Decem 20
	-----	-----
	(Unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents .....	\$ 12,318	\$ 1
Accounts receivable, less allowance for discounts and doubtful accounts of \$10,555 and \$8,964 for 2008 and 2007, respectively ...	279,869	20
Inventories .....	244,252	25
Deferred income taxes .....	13,897	1
Assets held for sale .....	1,930	
Prepaid expenses and other current assets .....	9,591	1
	-----	-----
Total current assets .....	561,857	50
Property, plant and equipment, net .....	68,766	7
Goodwill, net .....	41,403	4
Other intangibles, net .....	15,168	1
Other assets .....	30,650	4
	-----	-----
Total assets .....	\$ 717,844	\$ 67
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable .....	\$ 183,330	\$ 15
Current portion of long-term debt .....	119	
Accounts payable .....	71,604	6
Sundry payables and accrued expenses .....	27,645	2
Accrued customer returns .....	27,396	2
Accrued rebates .....	23,718	2
Payroll and commissions .....	16,534	1
	-----	-----
Total current liabilities .....	350,346	32
Long-term debt .....	90,425	9
Post-retirement medical benefits and other accrued liabilities .....	42,346	5
Accrued asbestos liabilities .....	22,434	2
	-----	-----
Total liabilities .....	505,551	48
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Common stock - par value \$2.00 per share:		
Authorized - 30,000,000 shares; issued 20,486,036 shares .....	40,972	4
Capital in excess of par value .....	58,684	5
Retained earnings .....	114,760	10
Accumulated other comprehensive income .....	18,609	
Treasury stock - at cost 1,929,541 and 2,189,079 shares in 2008 and 2007, respectively	(20,732)	(2)
	-----	-----
Total stockholders' equity .....	212,293	18
	-----	-----
Total liabilities and stockholders' equity .....	\$ 717,844	\$ 67
	=====	=====

See accompanying notes to consolidated financial statements.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

Six Months  
June

2008

(Unaudited)

## CASH FLOWS FROM OPERATING ACTIVITIES:

Net earnings .....	\$ 11,926	\$
Adjustments to reconcile net earnings to net cash used in operating activities:		
Depreciation and amortization .....	6,958	
Increase in allowance for doubtful accounts .....	407	
Increase in inventory reserves .....	1,379	
Gain on sale of building .....	(21,321)	
Loss on disposal of property, plant and equipment .....	112	
Loss from extinguishment of debt .....	1,444	
Equity (income) loss from joint ventures .....	128	
Loss on impairment of assets .....	355	
Employee stock ownership plan allocation .....	799	
Stock-based compensation .....	658	
Decrease in deferred income taxes .....	15,334	
Loss from discontinued operation, net of income tax .....	649	
Change in assets and liabilities:		
Increase in accounts receivable .....	(75,830)	
Decrease (increase) in inventories .....	6,646	
Decrease (increase) in prepaid expenses and other current assets .....	1,592	
Decrease (increase) in other assets .....	2,475	
Increase in accounts payable .....	4,100	
Increase in sundry payables and accrued expenses .....	4,683	
(Decrease) increase in other liabilities .....	(11,687)	
Net cash used in operating activities .....	(49,193)	

## CASH FLOWS FROM INVESTING ACTIVITIES:

Proceeds from the sale of property, plant and equipment .....	24
Net cash received from the sale of building .....	37,341
Capital expenditures .....	(5,347)
Net cash provided by (used in) investing activities .....	32,018

## CASH FLOWS FROM FINANCING ACTIVITIES:

Net borrowings under line-of-credit agreements .....	25,492
Defeasance of mortgage loan .....	(7,755)
Net repayment of long-term debt .....	(256)
Increase in overdraft balances .....	3,121
Proceeds from exercise of employee stock options .....	--
Excess tax benefits related to the exercise of employee stock options .....	--
Dividends paid .....	(3,313)
Net cash provided by financing activities .....	17,289

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Effect of exchange rate changes on cash .....	(1,057)
	-----
Net decrease in cash and cash equivalents .....	(943)
CASH AND CASH EQUIVALENTS at beginning of the period .....	13,261
	-----
CASH AND CASH EQUIVALENTS at end of the period .....	\$ 12,318
	=====

Supplemental disclosure of cash flow information: Cash paid during the period for:

Interest .....	\$ 7,493
	=====
Income taxes .....	\$ 2,014
	=====

See accompanying notes to consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
THREE MONTHS ENDED JUNE 30, 2008  
(Unaudited)

(In thousands)	COMMON STOCK -----	CAPITAL IN EXCESS OF PAR VALUE -----	RETAINED EARNINGS -----	ACCUMULATED OTHER COMPREHENSIVE INCOME -----	TREASURY STOCK -----
Balance at March 31, 2008 .....	\$ 40,972	\$ 58,755	\$ 117,520	\$ 4,968	\$ (21,250)
Comprehensive income:					
Net loss .....			(1,095)		
Foreign currency translation adjustment .....				(238)	
Pension and retiree medical adjustment .....				13,879	
Total comprehensive income .			(1,665)		
Cash dividends paid .....					
Stock-based compensation .....		(71)			518
Balance at June 30, 2008 .....	\$ 40,972	\$ 58,684	\$ 114,760	\$ 18,609	\$ (20,732)
	=====	=====	=====	=====	=====

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
SIX MONTHS ENDED JUNE 30, 2008  
(Unaudited)

(In thousands)	COMMON STOCK	CAPITAL IN EXCESS OF PAR VALUE	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME	TREASURY STOCK	TO
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Balance at December 31, 2007 ...	\$ 40,972	\$ 59,220	\$106,147	\$ 5,546	\$(23,521)	\$188
Comprehensive income:						
Net earnings .....			11,926			11
Foreign currency translation adjustment .....				(798)		
Pension and retiree medical adjustment .....				13,861		13
Total comprehensive income .						24
Cash dividends paid .....			(3,313)			(3)
Stock-based compensation .....		12			645	
Employee Stock Ownership Plan ..		(548)			2,144	1
Balance at June 30, 2008 .....	\$ 40,972	\$ 58,684	\$114,760	\$ 18,609	\$(20,732)	\$212
	=====	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. BASIS OF PRESENTATION:

Standard Motor Products, Inc. (referred to hereinafter in these notes to consolidated financial statements as the "Company," "we," "us," or "our") is engaged in the manufacture and distribution of replacement parts for motor vehicles in the automotive aftermarket industry.

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, 2007. The unaudited consolidated financial statements include our accounts and all domestic and international companies in which we have more than a 50% equity ownership. Our investments in unconsolidated affiliates are accounted for on the equity method. All significant inter-company items have been eliminated.

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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

The impact and any associated risks related to significant accounting 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, 2007.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS 157 is effective for the fiscal year beginning after November 15, 2007, which for us is the year ending December 31, 2008. As of January 1, 2008, we adopted SFAS 157. The adoption of SFAS 157 did not impact our consolidated financial statements in any material respect.

In December 2007, the FASB issued FSP FAS 157-b to defer SFAS 157's effective date for all non-financial assets and liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until years beginning after November 15, 2008. Derivatives measured at fair value under FAS 133 were not deferred under FSP FAS 157-b. We are assessing the impact, if any, which the adoption of FSP FAS 157-b will have on our consolidated financial position, results of operations and cash flows.

#### FAIR VALUE OPTIONS FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), including an amendment of FASB Statement No. 115. SFAS 159 permits an entity to measure certain



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financial assets and financial liabilities at fair value. The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The new Statement establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007, and is effective for us as of January 1, 2008. The adoption of SFAS 159 did not impact our consolidated financial statements in any material respect.

### BUSINESS COMBINATIONS

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for the fiscal year beginning after December 15, 2008, which for us is the fiscal year beginning January 1, 2009. SFAS 141R will have an impact on the manner in which we account for future acquisitions beginning in the fiscal year 2009.

### NON-CONTROLLING INTERESTS IN CONSOLIDATED FINANCIAL STATEMENTS

In December 2007, the FASB issued SFAS No. 160, "Non-Controlling Interests in Consolidated Financial Statements - an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, which for us is the fiscal year beginning January 1, 2009. We are assessing the impact, if any, which the adoption of SFAS 160 will have on our consolidated financial position, results of operations and cash flows.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

### DISCLOSURES ABOUT DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). This Statement requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. This Statement is effective for financial statements issued for fiscal years and interim periods

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beginning after November 15, 2008, which for us is the fiscal year beginning January 1, 2009. We are assessing the impact, if any, which the adoption of SFAS 161 will have on our financial statement disclosures.

### CONVERTIBLE DEBT INSTRUMENTS

In May 2008, the FASB issued FASB Staff Position APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion" ("FSP APB 14-1") which requires issuers of convertible debt that may be settled wholly or partly in cash to account for the debt and equity components separately. This FSP is effective for fiscal years beginning after December 15, 2008, which for us is the fiscal year beginning January 1, 2009 and must be applied retrospectively to all periods presented. We are assessing the impact, if any, which the adoption of FSP APB 14-1 will have on our financial statements.

### NOTE 3. RESTRUCTURING AND INTEGRATION COSTS

#### RESTRUCTURING COSTS

In connection with our acquisition of substantially all of the assets and the assumption of substantially all of the operating liabilities of Dana Corporation's Engine Management Group ("DEM") in June 2003, we established restructuring accruals relating to the consolidation of DEM into our existing operations. Of the original provision, we have a restructuring accrual of \$0.8 million remaining as of June 30, 2008. The restructuring accrual relates to work force reductions, employee termination benefits and contract termination costs.

#### INTEGRATION EXPENSES

Integration expenses relate primarily to the cost of moving and closing our Puerto Rico production operations, the integration of operations in Mexico, the closure of our Fort Worth, Texas and Long Island City, New York production facilities, and the cost of consolidating our European production operations. During 2008, we incurred integration expenses of \$4.2 million, relating to workforce reductions of \$3.1 million primarily at our Long Island City, New York and Puerto Rico production facilities and other exit costs of \$1.1 million. Other exit costs consist primarily of lease and contract termination costs and the cost of upkeep at vacated facilities. Cash payments made during the first six months of 2008 were \$4.7 million and will continue related to our pension plan withdrawal liability over a period which is not to exceed 20 years.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

Selected information relating to integration activities is as follows (in thousands):

(in thousands)	Workforce Reduction	Other Exit Costs	Total
	-----	-----	-----
Exit activity liability at December 31, 2007 ..	\$ 5,591	\$ 2,507	\$ 8,098

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Amounts provided for during 2008 .....	3,063	1,149	4,212
Adjustments .....	(28)	135	107
Cash payments during 2008 .....	(3,209)	(1,536)	(4,745)
	-----	-----	-----
Exit activity liability at June 30, 2008 .....	\$ 5,417	\$ 2,255	\$ 7,672
	-----	-----	-----

As of June 30, 2008, in accordance with the requirements of FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we have reported \$2 million as assets held for sale on our consolidated balance sheet related to the net book value of two buildings in our European Segment. Following plant closures resulting from integration activities, these buildings have been vacant and therefore a decision to solicit bids has been made. We anticipate that a negotiated sale to a third-party will occur within the next twelve months and will record any resulting gain in other income as appropriate.

#### NOTE 4. SALE OF LONG ISLAND CITY, NEW YORK PROPERTY

In March 2008, we completed the sale of the Long Island City, New York property and entered into a Lease Agreement with the purchaser whereby we would lease space at the property. The purchase price for the property was \$40.6 million with the proceeds used to reduce debt. The initial term of the lease is ten years and contains four 5-year renewal options. During the first twelve months of the lease term, we will make initial annual rent payments of approximately \$2.6 million. Thereafter, we expect to reduce our leased space to 1.5 floors, and the annual rent payments will decrease to approximately \$1.1 million. The lease agreement provides that our rent payments will increase 3% per year for the first twenty years of the lease; provided that in years 11 and 16, the rent payment increase will be 10% and 5%, respectively.

The sale has been recorded as a sale and leaseback transaction. As our retention rights to the property will be more than minor but less than substantially all, a portion of the gain has been deferred. The total gain from the sale of the property was \$31.6 million, of which \$21.1 million was recognized upon closing with the balance of the gain deferred to be recognized over the initial term of the lease of ten years. In connection with the closing, we have defeased the existing mortgage loan on the property of \$7.8 million which resulted in a loss on the extinguishment of debt of \$1.4 million, consisting of fees and expenses of \$1 million and the write-off of deferred finance costs of \$0.4 million. The gain on the sale of the property and the loss on extinguishment of debt are included in other income, net in the consolidated statement of operations.

#### NOTE 5. SALE OF RECEIVABLES

In April 2008, we began to sell undivided interests in certain of our receivables to financial institutions. We entered these agreements at our discretion when we determined that the cost of factoring was less than the cost of servicing our receivables with existing debt. Pursuant to these agreements, we sold \$28 million of receivables during the second quarter of 2008. 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 in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities." A charge in the amount of \$0.3 million related to the sale of receivables is included in selling, general and administrative expense in our consolidated statement of operations for the three and six months ended June 30, 2008.

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

#### NOTE 6. INVENTORIES

Inventories consist of (in thousands):

	June 30, 2008	December 31, 2007
	-----	-----
Finished goods, net .....	\$169,096	\$182,914
Work in process, net .....	9,474	5,850
Raw materials, net .....	65,682	63,513
	-----	-----
Total inventories, net .....	\$244,252	\$252,277
	=====	=====

#### NOTE 7. CREDIT FACILITIES AND LONG-TERM DEBT

Total debt consists of (in thousands):

	June 30, 2008	December 31, 2007
	-----	-----
<b>CURRENT</b>		
Revolving credit facilities (1) .....	\$ 183,330	\$ 156,756
Current portion of mortgage loan (2) .....	--	7,891
Other .....	119	130
	-----	-----
	183,449	164,777
	-----	-----
<b>LONG-TERM DEBT</b>		
6.75% convertible subordinated debentures (3) ....	90,000	90,000
Mortgage loan (2) .....	--	7,891
Other .....	544	664
Less: current portion of long-term debt .....	(119)	(8,021)
	-----	-----
	90,425	90,534
	-----	-----
Total debt .....	\$ 273,874	\$ 255,311
	=====	=====

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

(2) The mortgage loan was secured by the Long Island City, New York property. In March 2008 in connection with the sale of the property, we defeased the mortgage loan.

(3) In July 2008, we repurchased \$7.6 million principal amount of the 6.75% convertible subordinated debentures. A gain on the repurchase of \$0.6 million will be recorded in the third quarter of 2008.

We had deferred financing costs of \$2.7 million as of December 31, 2007. These costs related to our revolving credit facility, the convertible subordinated debentures and the mortgage loan agreement. In March 2008 in connection with the

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sale of the Long Island City, New York property, we defeased the mortgage loan and deferred financing costs of \$0.4 million were written off. Deferred financing costs of \$2 million as of June 30, 2008 are being amortized in the amount of \$0.4 million in 2008, \$0.6 million in 2009, \$0.4 million in 2010 and \$0.6 million for the period 2011-2018.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

##### REVOLVING CREDIT FACILITY

In March 2007, we entered into a Second Amended and Restated Credit Agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The restated credit agreement provides for a line of credit of up to \$275 million (inclusive of the Canadian term loan described below) and expires in 2012. The restated credit agreement also provides a \$50 million accordion feature, which would allow us to expand the facility. Direct borrowings under the restated credit agreement bear interest at the LIBOR rate plus the applicable margin (as defined), or floating at the index rate plus the applicable margin, at our option, and the interest rate may vary depending upon our borrowing availability. The restated credit agreement is guaranteed by certain of our subsidiaries.

Borrowings under the restated credit agreement are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. After taking into account outstanding borrowings under the restated credit agreement, there was an additional \$97.3 million available for us to borrow pursuant to the formula at June 30, 2008, of which \$30 million is reserved for repayment, repurchase or redemption, as the case may be, of the aggregate outstanding amount of our convertible debentures. At June 30, 2008 and December 31, 2007, the interest rate on our restated credit agreement was 3.7% and 6.4%, respectively. Outstanding borrowings under the restated credit agreement (inclusive of the Canadian term loan described below), which are classified as current liabilities, were \$174.3 million and \$148.7 million at June 30, 2008 and December 31, 2007, respectively.

At any time that our borrowing availability in the aggregate is less than \$30 million and until such time that we have maintained an average borrowing availability in the aggregate of \$30 million or greater for a continuous period of ninety (90) days, the terms of our restated credit agreement provide for, among other provisions, financial covenants requiring us, on a consolidated basis, (1) to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months), and (2) to limit capital expenditure levels. As of June 30, 2008, we were not subject to these covenants. Availability under our restated credit agreement is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. In addition, the restated credit agreement provides that, beginning on January 15, 2008 and on a quarterly basis thereafter, \$15 million of our borrowing availability shall be reserved for the repayment, repurchase or redemption, as the case may be, of the aggregate outstanding amount of our convertible debentures. Our restated credit agreement also permits dividends and distributions by us provided specific conditions are met.

##### CANADIAN TERM LOAN

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In March 2007, we amended our credit agreement with GE Canada Finance Holding Company, for itself and as agent for the lenders. The amended credit agreement provides for a line of credit of up to \$12 million, of which \$7 million is currently outstanding and which amount is part of the \$275 million available for borrowing under our restated credit agreement with General Electric Capital Corporation (described above). The amended credit agreement is guaranteed and secured by us and certain of our wholly-owned subsidiaries and expires in 2012. Direct borrowings under the amended credit agreement bear interest at the same rate as our restated credit agreement with General Electric Capital Corporation (described above).

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

##### REVOLVING CREDIT FACILITY--EUROPE

Our European subsidiary has revolving credit facilities which, at June 30, 2008, provide for a line of credit up to \$10.1 million. The amount of short-term bank borrowings outstanding under these facilities was \$9 million on June 30, 2008 and \$8 million on December 31, 2007. The weighted average interest rate on these borrowings on June 30, 2008 was 6.2% and December 31, 2007 was 6.7%.

##### SUBORDINATED DEBENTURES

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

We may, from time to time, repurchase the debentures in the open market, or through privately negotiated transactions, on terms that we believe to be favorable with any gains or losses as a result of the difference between the net carrying amount and the reacquisition price recognized in the period of extinguishment. In July 2008, we repurchased \$7.6 million principal amount of the debentures resulting in a gain recorded on the repurchase of \$0.6 million, which will be recorded in the third quarter of 2008.

##### MORTGAGE LOAN AGREEMENT

In June 2003, we borrowed \$10 million under a mortgage loan agreement. In connection with the sale of the Long Island City, New York property in March 2008, we defeased the mortgage loan. We incurred fees and expenses in the defeasance of approximately \$1 million, and deferred finance costs capitalized of \$0.4 million were written off upon the defeasance.

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### NOTE 8. STOCK-BASED COMPENSATION PLANS

We account for our five stock-based compensation plans in accordance with the provisions of FASB Statement No. 123R, "Share-Based Payment" ("FAS 123R"), 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. That cost is recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award.

#### STOCK OPTION GRANTS

There were no stock options granted in the six months ended June 30, 2008 and 2007. We have recognized compensation expense for prior years' grants which vest after January 1, 2006 based on the grant-date fair value, estimated in accordance with SFAS 123 which was used in our prior pro forma disclosure. Our policy was to calculate the compensation expense related to the stock-based compensation granted to employees and directors on a straight-line basis over the full vesting period of the grants. The expense for the six months ended June 30, 2008 and 2007 reflects our estimate of expected forfeitures which we determine to be immaterial, based on history and remaining time until vesting of the remaining options.

As of June 30, 2008, we have no unrecognized compensation cost related to stock options and non-vested stock options.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

The following is a summary of the changes in outstanding stock options for the six months ended June 30, 2008:

	STOCK OPTIONS	WEIGHTED AVERAGE EXERCISE	WEIGHTED AVERAGE REMAINING CONTRACTU TERM (YRS)
	-----	-----	-----
Outstanding at January 1, 2008 .....	607,620	\$ 13.34	4.8
Exercised .....	--	--	--
Expired .....	(39,498)	11.92	--
Forfeited .....	(1,500)	11.35	6.9
Outstanding at June 30, 2008 .....	566,622	\$ 13.44	4.6

At June 30, 2008, the aggregated intrinsic value of outstanding and exercisable

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stock options was essentially zero. All outstanding stock options as of June 30, 2008 are exercisable.

### RESTRICTED AND PERFORMANCE STOCK GRANTS

As part of the 2006 Omnibus Incentive Plan, we currently grant shares of restricted and performance-based stock to eligible employees and directors. Selected executives and other key personnel are granted performance awards whose vesting is contingent upon meeting various performance measures with a retention feature. This component of compensation is designed to encourage the long-term retention of key executives and to tie executive compensation directly to Company performance and the long-term enhancement of shareholder value. The performance awards are earned at the end of the three year period provided that the strategic three year plan is achieved. Each period we evaluate the probability of achieving the applicable targets and we adjust our accrual accordingly.

Our restricted and performance-based share activity was as follows for the six months ended June 30, 2008:

	SHARES	WEIGHTED AVERAGE GRANT DATE FAIR VALUE PER SHARE
Outstanding at January 1, 2008 .....	193,200	\$ 7.25
Granted .....	6,000	7.94
Vested .....	(7,650)	12.46
Forfeited .....	(750)	6.92
Outstanding at June 30, 2008 .....	190,800	\$ 7.12

We recorded compensation expense related to restricted shares and performance-based shares of \$223,550 (\$128,319 net of tax) and \$123,400 (\$76,900 net of tax) for the six months ended June 30, 2008 and 2007, respectively. The unamortized compensation expense related to our restricted and performance-based shares were \$597,930 at June 30, 2008 and are expected to be recognized as they vest over a weighted average period of 1.6 and 0.7 years for employees and directors, respectively.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

#### NOTE 9. EMPLOYEE BENEFITS

In 2000, we created an employee benefits trust to which we contributed 750,000



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shares of treasury stock. We are authorized to instruct the trustees to distribute such shares toward the satisfaction of our future obligations under employee benefit plans. The shares held in trust are not considered outstanding for purposes of calculating earnings per share until they are committed to be released. The trustees will vote the shares in accordance with its fiduciary duties. During 2008, we contributed to the trust an additional 137,023 shares from our treasury and released 199,471 shares from the trust leaving 529 shares remaining in the trust as of June 30, 2008.

In August 1994, we established an unfunded Supplemental Executive Retirement Plan (SERP) for key employees. Under the plan, these employees may elect to defer a portion of their compensation and, in addition, we may at our discretion make contributions to the plan on behalf of the employees. In March 2008 and 2007, contributions of \$113,500 and \$83,000 were made related to calendar years 2007 and 2006, respectively.

In October 2001, we adopted a second unfunded 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 participants payment date based upon the employees' years of service and compensation. On June 15, 2008, a participant in the unfunded SERP reached his participant's payment date. In connection therewith, we recorded a settlement loss of \$0.6 million in June of 2008. The corresponding distribution of \$5 million was made in July 2008. We use a January 1 measurement date for this plan.

Our UK pension plan is comprised of a defined benefit plan and a defined contribution plan. The defined contribution benefit plan is closed to new entrants and existing active members ceased accruing any further benefits.

In December 2007, we entered into an agreement with the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America and its Local 365 regarding the shut down of our manufacturing operations at Long Island City, New York, which operations were transferred to other facilities. As part of the agreement, effective January 5, 2008, we agreed to withdraw from the multi-employer pension plan covering our UAW employees at the Long Island City facility. As a result, we incurred a withdrawal liability. The pension plan withdrawal liability is related to trust asset under-performance and is payable in a lump sum or over a period which is not to exceed 20 years. In December 2007, we recorded a charge of \$3.3 million, which is our best estimate of the withdrawal liability based upon information received from a third party actuary.

We provide certain medical and dental care benefits to eligible retired employees. Eligibility of employees who can participate in this program is limited to employees hired before 1996. On May 30, 2008, we announced that in lieu of the current retiree medical and dental plans previously funded on a pay-as-you-go basis, a Health Reimbursement Account ("HRA") will be established beginning January 1, 2009 for each qualified retiree. The plan amendment will effectively reduce benefits attributed to employee services already rendered and credit a fixed amount into an HRA to cover both medical and dental costs for all current and future eligible retirees. The remeasurement of the postretirement welfare benefit plan as a result of these benefit modifications generated a \$24.5 million reduction in the accumulated postretirement benefit obligation on June 1, 2008 which will be amortized on a straight-line basis and recognized as a reduction in benefit costs over the remaining service to full eligibility (3.8 years). The annual reduction to expense over the amortization period will be \$6.4 million commencing on June 1, 2008.

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

The components of net periodic benefit cost for our North America and European defined benefit plans and post retirement benefit plans for the three months and six months ended June 30, 2008 and 2007 were as follows (in thousands):

PENSION BENEFITS	Three months ended June 30,		Six months Ended June 30,	
	2008	2007	2008	2007
	-----	-----	-----	-----
Service cost .....	\$ (61)	\$ 98	\$ 46	\$ 196
Interest cost .....	144	114	279	228
Amortization of prior service cost ..	27	28	55	56
Actuarial net (gain) loss .....	521	(28)	525	(56)
	-----	-----	-----	-----
Net periodic benefit cost .....	\$ 631	\$ 212	\$ 905	\$ 424
	=====	=====	=====	=====

POSTRETIREMENT BENEFITS	Three months ended June 30,		Six months Ended June 30,	
	2008	2007	2008	2007
	-----	-----	-----	-----
Service cost .....	\$ 188	\$ 203	\$ 400	\$ 406
Interest cost .....	551	541	1,135	1,082
Amortization of prior service credit	(1,246)	(713)	(1,959)	(1,426)
Amortization of unrecognized loss ...	1	1	2	2
Actuarial net loss .....	405	288	698	576
	-----	-----	-----	-----
Net periodic benefit cost .....	\$ (101)	\$ 320	\$ 276	\$ 640
	=====	=====	=====	=====

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

NOTE 10. 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):

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	Three Months Ended June 30,		Six Mon Jun
	2008	2007	2008
BASIC NET EARNINGS (LOSS) PER COMMON SHARE:			
Earnings (loss) from continuing operations .....	\$ (772)	\$ 5,656	\$ 12,575
Loss from discontinued operation .....	(323)	(279)	(649)
Net earnings (loss) available to common stockholders .....	\$ (1,095)	\$ 5,377	\$ 11,926
	=====	=====	=====
Weighted average common shares outstanding .....	18,332	18,781	18,320
Net earnings (loss) from continuing operations per common share .....	\$ (0.04)	\$ 0.30	\$ 0.69
Loss from discontinued operations per common share .....	(0.02)	(0.01)	(0.04)
Basic net earnings (loss) per common share .....	\$ (0.06)	\$ 0.29	\$ 0.65
	=====	=====	=====
DILUTED NET EARNINGS (LOSS) PER COMMON SHARE:			
Earnings (loss) from continuing operations .....	\$ (772)	\$ 5,656	\$ 12,575
Interest income on debenture conversions (increase is net of income tax expense) .....	--	--	1,822
Earnings (loss) from continuing operations plus assumed conversions .....	(772)	5,656	14,397
Loss from discontinued operation .....	(323)	(279)	(649)
Net earnings (loss) available to common stockholders plus assumed conversions .....	\$ (1,095)	\$ 5,377	\$ 13,748
	=====	=====	=====
Weighted average common shares outstanding - Basic ....	18,332	18,781	18,320
PLUS INCREMENTAL SHARES FROM ASSUMED CONVERSIONS:			
Dilutive effect of restricted stock .....	53	65	42
Dilutive effect of stock options .....	--	95	--
Dilutive effect of convertible debentures .....	--	--	2,796
Weighted average common shares outstanding - Diluted ..	18,385	18,941	21,158
	=====	=====	=====
Net earnings (loss) from continuing operations per common share .....	\$ (0.04)	\$ 0.30	\$ 0.68
Loss from discontinued operations per common share .....	(0.02)	(0.02)	(0.03)
Diluted net earnings (loss) per common share .....	\$ (0.06)	\$ 0.28	\$ 0.65
	=====	=====	=====

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## STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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 (in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Stock options.....	567	6	567	6
Convertible debentures.....	2,796	2,796	--	2,796

#### NOTE 11. COMPREHENSIVE INCOME

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net earnings (loss) as reported .....	\$ (1,095)	\$ 5,377	\$ 11,926	\$ 7,964
Foreign currency translation adjustment .....	(238)	1,612	(798)	1,761
Postretirement benefit plans:				
Plan amendment adjustment .....	14,708	--	14,708	--
Reclassification adjustment for recognition of prior period amounts .....	(318)	--	(336)	--
Unrecognized amounts .....	(511)	--	(511)	(1)
Total comprehensive income .....	\$ 12,546	\$ 6,989	\$ 24,989	\$ 9,724

#### NOTE 12. INDUSTRY SEGMENTS

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

Three Months Ended June 30,	
-----	-----
2008	2007

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	OPERATING INCOME		OPERATING INCOME	
	NET SALES	(LOSS)	NET SALES	(LOSS)
Engine Management .....	\$138,482	\$ 4,024	\$138,096	\$ 12,833
Temperature Control .....	61,489	3,172	63,612	3,667
Europe .....	12,563	373	11,196	595
All Other .....	2,809	(3,040)	4,046	(4,289)
Consolidated .....	\$215,343	\$ 4,529	\$216,950	\$ 12,806

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STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

	Six Months Ended June 30,			
	2008		2007	
	NET SALES	OPERATING INCOME (LOSS)	NET SALES	OPERATING INCOME (LOSS)
Engine Management .....	\$281,844	\$ 13,214	\$275,526	\$ 23,930
Temperature Control .....	111,062	2,368	114,138	5,626
Europe .....	23,807	869	21,689	1,379
All Other .....	6,714	(7,596)	5,412	(9,663)
Consolidated .....	\$423,427	\$ 8,855	\$416,765	\$ 21,272

NOTE 13. COMMITMENTS AND CONTINGENCIES

ASBESTOS. In 1986, we acquired a brake business, which we subsequently sold in March 1998 and which is accounted for as a discontinued operation. When we originally acquired this brake business, we assumed future liabilities relating to any alleged exposure to asbestos-containing products manufactured by the seller of the acquired brake business. In accordance with the related purchase agreement, we agreed to assume the liabilities for all new claims filed on or after September 1, 2001. Our ultimate exposure will depend upon the number of claims filed against us on or after September 1, 2001 and the amounts paid for indemnity and defense thereof. At June 30, 2008, approximately 3,560 cases were outstanding for which we were responsible for any related liabilities. We expect the outstanding cases to increase gradually due to legislation in certain states mandating minimum medical criteria before a case can be heard. Since inception in September 2001 through June 30, 2008, the amounts paid for settled claims are

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approximately \$6.5 million. In September 2007, we entered into an agreement with an insurance carrier to provide us with limited insurance coverage for the defense and indemnity costs associated with certain asbestos-related claims. We have submitted various asbestos-related claims to the insurance carrier for coverage under this agreement.

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

The most recent actuarial study was performed as of August 31, 2007. The updated study has estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$23.8 million to \$55.2 million for the period through 2050. The change from the prior year study was a \$1.7 million increase for the low end of the range and a \$1.3 million increase for the high end of the range. Based on the information contained in the actuarial study and all other available information considered by us, we concluded that no amount within the range of settlement payments was more likely than any other and, therefore, recorded the low end of the range as the liability associated with future settlement payments through 2050 in our consolidated financial statements. Accordingly, an incremental \$2.8 million provision in our discontinued operation was added to the asbestos accrual in September 2007 increasing the reserve to approximately \$23.8 million. According to the updated study, legal costs, which are expensed as incurred and reported in earnings (loss) from discontinued operation in the accompanying statement of operations, are estimated to range from \$18.7 million to \$32.6 million during the same period.

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### STANDARD MOTOR PRODUCTS, INC. AND SUBSIDIARIES

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

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.

ANTITRUST LITIGATION. In November 2004, we were served with a summons and complaint in the U.S. District Court for the Southern District of New York by The Coalition For A Level Playing Field, which is an organization comprised of a large number of auto parts retailers. The complaint alleges antitrust violations by us and a number of other auto parts manufacturers and retailers and seeks

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injunctive relief and unspecified monetary damages. In August 2005, we filed a motion to dismiss the complaint, following which the plaintiff filed an amended complaint dropping, among other things, all claims under the Sherman Act. The remaining claims allege violations of the Robinson-Patman Act. Motions to dismiss those claims were filed by us in February 2006. Plaintiff filed opposition to our motions, and we subsequently filed replies in June 2006. Oral arguments were originally scheduled for September 2006, however the court adjourned these proceedings until a later date to be determined. Subsequently, the judge initially assigned to the case recused himself, and a new judge has been assigned before whom further preliminary proceedings have been held. Although we cannot predict the ultimate outcome of this case or estimate the range of any potential loss that may be incurred in the litigation, we believe that the lawsuit is without merit, deny all of the plaintiff's allegations of wrongdoing and believe we have meritorious defenses to the plaintiff's claims. We intend to defend vigorously this lawsuit.

OTHER LITIGATION. We are involved in various other litigation and product liability matters arising in the ordinary course of business. Although the final outcome of any asbestos-related matters or any other litigation or product liability matter cannot be determined, based on our understanding and evaluation of the relevant facts and circumstances, it is our opinion that the final outcome of these matters will not have a material adverse effect on our business, financial condition or results of operations.

WARRANTIES. We generally warrant our products against certain manufacturing and other defects. These product warranties are provided for specific periods of time of the product depending on the nature of the product. As of June 30, 2008 and 2007, we have accrued \$13.1 million and \$14.7 million, respectively, for estimated product warranty claims included in accrued customer returns. The accrued product warranty costs are based primarily on historical experience of actual warranty claims.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Balance, beginning of period .....	\$ 11,141	\$ 11,904	\$ 11,317	\$ 11,704
Liabilities accrued for current year sales	13,372	13,860	23,914	26,398
Settlements of warranty claims .....	(11,398)	(11,049)	(22,116)	(23,387)
	-----	-----	-----	-----
Balance, end of period .....	\$ 13,115	\$ 14,715	\$ 13,115	\$ 14,715
	=====	=====	=====	=====

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## RESULTS OF OPERATIONS

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS MADE PURSUANT TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. FORWARD-LOOKING STATEMENTS IN THIS REPORT ARE INDICATED BY WORDS SUCH AS "ANTICIPATES," "EXPECTS," "BELIEVES," "INTENDS," "PLANS," "ESTIMATES," "PROJECTS" AND SIMILAR EXPRESSIONS. THESE STATEMENTS REPRESENT OUR EXPECTATIONS BASED ON CURRENT INFORMATION AND ASSUMPTIONS AND ARE INHERENTLY SUBJECT TO RISKS AND UNCERTAINTIES. OUR ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE WHICH ARE ANTICIPATED OR PROJECTED AS A RESULT OF CERTAIN RISKS AND UNCERTAINTIES, INCLUDING, BUT NOT LIMITED TO, ECONOMIC AND MARKET CONDITIONS; THE PERFORMANCE OF THE AFTERMARKET SECTOR; CHANGES IN BUSINESS RELATIONSHIPS WITH OUR MAJOR CUSTOMERS AND IN THE TIMING, SIZE AND CONTINUATION OF OUR CUSTOMERS' PROGRAMS; CHANGES IN THE PRODUCT MIX AND DISTRIBUTION CHANNEL MIX; THE ABILITY OF OUR CUSTOMERS TO ACHIEVE THEIR PROJECTED SALES; COMPETITIVE PRODUCT AND PRICING PRESSURES; INCREASES IN PRODUCTION OR MATERIAL COSTS THAT CANNOT BE RECOUPED IN PRODUCT PRICING; SUCCESSFUL INTEGRATION OF ACQUIRED BUSINESSES; PRODUCT AND ENVIRONMENTAL LIABILITY MATTERS (INCLUDING, WITHOUT LIMITATION, THOSE RELATED TO ASBESTOS-RELATED CONTINGENT LIABILITIES OR ENVIRONMENTAL REMEDIATION LIABILITIES); AS WELL AS OTHER RISKS AND UNCERTAINTIES, SUCH AS THOSE DESCRIBED UNDER RISK FACTORS, QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK AND THOSE DETAILED HEREIN AND FROM TIME TO TIME IN THE FILINGS OF THE COMPANY WITH THE SEC. FORWARD-LOOKING STATEMENTS ARE MADE ONLY AS OF THE DATE HEREOF, AND THE COMPANY UNDERTAKES NO OBLIGATION TO UPDATE OR REVISE THE FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE. IN ADDITION, HISTORICAL INFORMATION SHOULD NOT BE CONSIDERED AS AN INDICATOR OF FUTURE PERFORMANCE. THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS, INCLUDING THE NOTES THERETO, INCLUDED ELSEWHERE IN THIS REPORT.

## BUSINESS OVERVIEW

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

We place significant emphasis on improving our financial performance by achieving operating efficiencies and improving asset utilization, while maintaining product quality and high customer order fill rates. We intend to continue to improve our operating efficiency and cost position by focusing on company-wide overhead and operating expense cost reduction programs, such as closing excess facilities and consolidating redundant functions. In that regard, we are closing our Puerto Rico manufacturing facility, integrating operations in Mexico, and have closed our Fort Worth, Texas and Long Island City, New York manufacturing operations.

SEASONALITY. Historically, our operating results have fluctuated by quarter, with the greatest sales occurring in the second and third quarters of the year and revenues generally being recognized at the time of shipment. It is in these quarters that demand for our products is typically the highest, specifically in the Temperature Control Segment of our business. In addition to this seasonality, the demand for our Temperature Control products during the second and third quarters of the year may vary significantly with the summer weather and customer inventories. For example, a cool summer may lessen the demand for our Temperature Control products, while a hot summer may increase such demand. As a result of this seasonality and variability in demand of our Temperature



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Control products, our working capital requirements peak near the end of the second quarter, as the inventory build-up of air conditioning products is converted to sales and payments on the receivables associated with such sales have yet to be received. During this period, our working capital requirements are typically funded by borrowing from our revolving credit facility.

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

INVENTORY MANAGEMENT. We face inventory management issues as a result of warranty and overstock returns. Many of our products carry a warranty ranging from a 90-day limited warranty to a lifetime limited warranty, which generally covers defects in materials or workmanship and failure to meet industry published specifications. In addition to warranty returns, we also permit our customers to return products to us within customer-specific limits (which are generally limited to a specified percentage of their annual purchases from us) in the event that they have overstocked their inventories. 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 tightened the rules for authorized warranty returns, placed further restrictions on the amounts customers can return and instituted a program so that our management can better estimate potential future product returns. Despite the additional controls, in the fourth quarter of 2007, we experienced significant overstock returns as customers reduced their working capital levels in response to a difficult economic climate. During 2008, we are establishing reserves for overstock returns which reflect the impact of the significant returns experienced in the fourth quarter of 2007. In addition, with respect to our air conditioning compressors, our most significant customer product warranty returns, we established procedures whereby a warranty will be voided if a customer does not provide acceptable proof that complete AC system repair was performed.

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

INTERIM RESULTS OF OPERATIONS:

COMPARISON OF THREE MONTHS ENDED JUNE 30, 2008 TO THREE MONTHS ENDED

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JUNE 30, 2007

SALES. Consolidated net sales for the three months ended June 30, 2008 were \$215.3 million, a decrease of \$1.7 million, or 0.7%, compared to \$217 million in the same period of 2007. The decrease in consolidated net sales resulted primarily from decreases in net sales of \$2.1 million in our Temperature Control Segment and \$1.2 million in our Other Operating Segment, which consists primarily of our Canadian operations, partially offset by growth in our European Operations which recorded an increase in net sales of \$1.4 million or 12.2% as a result of increased sales volumes due to new product introductions. The decline in Temperature Control and the Other Operating Segment net sales was the result of further price reductions initiated in 2008 to compete against low cost Chinese imports of new compressors partially offset by a favorable change in foreign currency exchange rates in our Canadian operations as compared to the second quarter of 2007.

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GROSS MARGINS. Gross margins, as a percentage of consolidated net sales, decreased to 22.6% in the second quarter of 2008, compared to 26.1% in the second quarter of 2007. The decrease resulted primarily from decreases in Engine Management margins of 5.2 percentage points and Temperature Control margins of 1.1 percentage points. The decrease in the Engine Management margin was primarily due to unabsorbed overhead during our planned closure of two manufacturing facilities, start up and training costs at our new Mexico facility, and an increase in sales from our OES customers with lower margins. The Temperature Control Segment's 1.1 percentage point decrease resulted primarily from price reductions initiated in 2008 to compete against low cost Chinese imports.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses (SG&A) decreased by \$0.6 million to \$42.7 million in the second quarter of 2008, as compared to \$43.3 million in the second quarter of 2007. As a percentage of net sales, SG&A expenses decreased to 19.8% in the second quarter of 2008 as compared to 20% in the comparable period in 2007.

RESTRUCTURING AND INTEGRATION EXPENSES. Restructuring and integration expenses increased to \$1.4 million in the second quarter of 2008, compared to \$0.6 million in the second quarter of 2007. The 2008 expenses related primarily to charges incurred for severance and related costs in connection with the shutdown of our Long Island City, New York manufacturing operations. Restructuring and integration expense for the second quarter of 2007 related primarily to charges in connection with the closure of our Puerto Rico manufacturing operations.

OPERATING INCOME. Operating income, was \$4.5 million in the second quarter of 2008, compared to \$12.8 million in the second quarter of 2007. The decrease of \$8.3 million was due primarily to lower gross margins as a percentage of sales driven by higher manufacturing costs from unabsorbed overhead during our planned transition to new manufacturing facilities and higher restructuring and integration expenses.

OTHER INCOME, NET. Other income, net in the second quarter of 2008 was \$0.8 million lower than other income, net in the same period in 2007. Other income, net in the second quarter of 2008 included recognition of the deferred gain on the sale of our Long Island City, New York property and foreign exchange gains, which gains were offset by losses from our joint ventures and from the disposal of certain of our fixed assets.

INTEREST EXPENSE. Interest expense decreased by \$1.4 million in the second

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quarter 2008 compared to the same period in 2007 mainly due to lower borrowing costs as a result of the interest rate benefit on our restated credit agreement entered into in March 2007.

**INCOME TAX PROVISION.** The income tax provision was \$1.9 million in the second quarter of 2008 compared to \$3.1 million for the same period in 2007. The income tax provision in the second quarter of 2008 includes the tax impact of the non-deductibility of a portion of the \$5 million distribution to a participant in the unfunded supplemental executive retirement plan and a tollgate tax on our operations in Puerto Rico. The effective tax rate for the second quarter of 2007 was 35.7%

**LOSS FROM DISCONTINUED OPERATION.** Loss from discontinued operation, net of tax, reflects legal expenses associated with our asbestos related liability. We recorded \$0.3 million as a loss from discontinued operation for the second quarter of 2008 and 2007. As discussed more fully in Note 13 in the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

COMPARISON OF SIX MONTHS ENDED JUNE 30, 2008 TO SIX MONTHS ENDED JUNE 30, 2007

**SALES.** Consolidated net sales for the six months ended June 30, 2008 were \$423.4 million, an increase of \$6.6 million, or 1.6%, compared to \$416.8 million in the same period of 2007. The increase in consolidated net sales resulted primarily from growth in Engine Management net sales which increased \$6.3 million or 2.3%, an increase of \$2.1 million in our European Segment and \$1.3 million in our Other Operating Segment, which consists primarily of our Canadian operations,

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partially offset by a decrease in net sales of \$3.1 million or 2.7% in our Temperature Control Segment. The Engine Management sales growth was mainly due to continued sales volume increases from our OES customers. The European Segment witnessed increased sales volumes due to new product introductions and our Other Operating Segment benefited from increased volumes and a favorable change in foreign currency exchange rates as compared to 2007 in our Canadian business. The decline in Temperature Control net sales is the result of further price reductions initiated in 2008 to compete against low cost Chinese imports.

**GROSS MARGINS.** Gross margins, as a percentage of consolidated net sales, decreased to 23.6% for the six months ended June 30, 2008 compared to 26% in the same period of 2007. The lower gross margin resulted from decreases in Engine Management margins of 3 percentage points, Temperature Control margins of 3.1 percentage points offset, in part, by a 0.6 percentage point increase in margin in our European Segment. The decrease in the Engine Management margin was primarily due to unabsorbed fixed costs in our planned closure of the Puerto Rico and Long Island City, New York manufacturing plants, start up and training costs at our new Mexico plant, and an increase in sales from our OES customers with lower margins. Temperature Control's gross margin decrease resulted primarily from price reductions initiated in 2008 and changes in product mix where sales of lower margin products have increased. Europe's increase in gross margin was due to increased volumes, higher margin sales from our Kerr Nelson acquisition, and a shift in raw material procurements from Asia.

**SELLING, GENERAL AND ADMINISTRATIVE EXPENSES.** Selling, general and administrative expenses (SG&A) increased by \$0.7 million to \$86.8 million in the first six months of 2008, as compared to \$86.1 million for the six months ended June 30, 2007. As a percentage of net sales, SG&A expenses decreased to 20.5% in the first six months of 2008 as compared to 20.6% in the comparable period in 2007.

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RESTRUCTURING AND INTEGRATION EXPENSES. Restructuring and integration expenses increased to \$4.2 million for the six months ended June 30, 2008, compared to \$1.2 million in the same period of 2007. The 2008 expenses related primarily to charges incurred for severance and related costs in connection with the shutdown of our Long Island City, New York manufacturing operations. Restructuring and integration expense for 2007 related primarily to charges in connection with the closure of our Puerto Rico manufacturing operations.

OPERATING INCOME. Operating income was \$8.9 million in the first six months of 2008, compared to \$21.3 million in 2007. The decrease of \$12.4 million was due primarily to lower gross margins as a percentage of sales driven by higher cost of goods sold due to unabsorbed fixed costs during our planned transition to new manufacturing facilities, and increased restructuring and integration expenses which more than offset the increase in consolidated net sales.

OTHER INCOME, NET. Other income, net increased to \$20.4 million for the six months ended June 30, 2008, compared to \$1 million in the same period of 2007. During 2008, we completed the sale of our Long Island City, New York property for a purchase price of \$40.6 million resulting in a recognized gain in 2008 of \$21.3 million, offset partially by a \$1.4 million charge related to the defeasance of our mortgage on the property.

INTEREST EXPENSE. Interest expense decreased by \$2 million in the six months ended June 30, 2008, compared to the same period in 2007 mainly due to lower borrowing costs as a result of a reduction in the interest rate on our restated credit agreement entered into in March 2007.

INCOME TAX PROVISION. The income tax provision was \$9.3 million for the six months ended June 30, 2008, compared to \$4.4 million for the same period in 2007. The increase was due to higher earnings and a higher effective tax rate for the six months of 2008, which is 42.6% in 2008 compared to 33.8% in the same period of 2007. The 2008 rate was higher primarily due to the differences in the mix of domestic and foreign earnings as a result of the gain on the sale of the Long Island City, New York property, the tax impact of the non-deductibility of a portion of the \$5 million distribution to a participant in the unfunded supplemental executive retirement plan, and a tollgate tax on our operations in Puerto Rico. The 2007 rate was reduced by a benefit from discreet items.

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LOSS FROM DISCONTINUED OPERATION. Loss from discontinued operation, net of tax, reflects legal expenses associated with our asbestos related liability. We recorded \$0.6 million as a loss from discontinued operation for the six months ended 2008 and 2007. As discussed more fully in Note 13 in the notes to our consolidated financial statements, we are responsible for certain future liabilities relating to alleged exposure to asbestos containing products.

### LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES. During the first six months of 2008, cash used in operations amounted to \$49.2 million compared to cash used in operations of \$39.5 million in the same period of 2007. The year-over-year increase in cash used in operations is primarily the result of an increase in operating working capital. Due to the seasonality in our business, operating working capital tends to build during the first half of the year before peaking near the end of the second quarter which is reflected by the increase in accounts receivable. This was partially offset by the reduction in inventory levels built up in preparation for our production facility moves.

INVESTING ACTIVITIES. Cash provided by investing activities was \$32 million in

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the first six months of 2008, compared to cash used in investing activities of \$6 million in the first six months of 2007. Cash provided by investing activities in 2008 includes \$37.3 million in net cash proceeds from the sale of the Long Island City, New York property. Capital expenditures in the first six months of 2008 were \$5.3 million compared to \$6.1 million in the comparable period last year.

FINANCING ACTIVITIES. Cash provided by financing activities was \$17.3 million in the first six months of 2008, compared to cash provided by financing activities of \$43.2 million in the same period of 2007. The decrease is primarily due to the reduction in borrowings under our line of credit reflecting the impact of the net cash proceeds received from the sale of the Long Island City, New York property, of which a portion was used to defease the remaining \$7.8 million mortgage loan on the property and to repay debt. In addition, there was no exercise activity in employee stock options during the first six months of 2008 compared to 2007 activity for the same period that resulted in \$4.2 million of proceeds.

In March 2007, we entered into a Second Amended and Restated Credit Agreement with General Electric Capital Corporation, as agent, and a syndicate of lenders for a secured revolving credit facility. The restated credit agreement provides for a line of credit of up to \$275 million (inclusive of the Canadian term loan described below) and expires in 2012. The restated credit agreement also provides a \$50 million accordion feature, which would allow us to expand the facility. Direct borrowings under the restated credit agreement bear interest at the LIBOR rate plus the applicable margin (as defined), or floating at the index rate plus the applicable margin, at our option. The interest rate may vary depending upon our borrowing availability. The restated credit agreement is guaranteed by certain of our subsidiaries.

Borrowings under the restated credit agreement are collateralized by substantially all of our assets, including accounts receivable, inventory and fixed assets, and those of certain of our subsidiaries. After taking into account outstanding borrowings under the restated credit agreement, there was an additional \$97.3 million available for us to borrow pursuant to the formula at June 30, 2008, of which \$30 million is reserved for repayment, repurchase or redemption, as the case may be, of the aggregate outstanding amount of our convertible debentures. At June 30, 2008 and December 31, 2007, the interest rate on our restated credit agreement was 3.7% and 6.4%, respectively. Outstanding borrowings under the restated credit agreement (inclusive of the Canadian term loan described below), which are classified as current liabilities, were \$174.3 million and \$148.7 million at June 30, 2008 and December 31, 2007, respectively.

At any time our borrowing availability in the aggregate is less than \$30 million and until such time that we have maintained an average borrowing availability in the aggregate of \$30 million or greater for a continuous period of 90 days, the terms of our restated credit agreement provide for, among other provisions, financial covenants requiring us, on a consolidated basis, (1) to maintain specified levels of fixed charge coverage at the end of each fiscal quarter (rolling twelve months), and (2) to limit capital expenditure levels. As of June

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30, 2008, we were not subject to these covenants. Availability under our restated credit agreement is based on a formula of eligible accounts receivable, eligible inventory and eligible fixed assets. In addition, the restated credit agreement provides that, beginning on January 15, 2008 and on a quarterly basis thereafter, \$15 million of our borrowing availability shall be reserved for the repayment, repurchase or redemption, as the case may be, of the aggregate outstanding amount of our convertible debentures. Our restated credit agreement

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also permits dividends and distributions by us provided specific conditions are met.

In March 2007, we amended our credit agreement with GE Canada Finance Holding Company, for itself and as agent for the lenders. The amended credit agreement provides for a line of credit of up to \$12 million, of which \$7 million is currently outstanding and which amount is part of the \$275 million available for borrowing under our restated credit agreement with General Electric Capital Corporation (described above). The amended credit agreement is guaranteed and secured by us and certain of our wholly-owned subsidiaries and expires in 2012. Direct borrowings under the amended credit agreement bear interest at the same rate as our restated credit agreement with General Electric Capital Corporation (described above).

Our European subsidiary has revolving credit facilities which, at June 30, 2008, provide for a line of credit up to \$10.1 million. The amount of short-term bank borrowings outstanding under these facilities was \$9 million on June 30, 2008 and \$8 million on December 31, 2007. The weighted average interest rate on these borrowings on June 30, 2008 was 6.2% and December 31, 2007 was 6.7%.

In July 1999, we issued convertible debentures, payable semi-annually, in the aggregate principal amount of \$90 million. The debentures carry an interest rate of 6.75%, payable semi-annually. The debentures are convertible into 2,796,120 shares of our common stock, and mature on July 15, 2009. We may, from time to time, repurchase the debentures in the open market, or through privately negotiated transactions, on terms that we believe to be favorable with any gains or losses as a result of the difference between the net carrying amount and the reacquisition price recognized in the period of extinguishment. We intend to fund any such purchases from available cash and cash flows. Any such settlements may be suspended or discontinued at any time. In July 2008, we repurchased \$7.6 million principal amount of the debentures resulting in a gain recorded on the repurchase of \$0.6 million, which will be recorded in the third quarter of 2008.

In order to reduce our accounts receivable balances and improve our cash flow, we sold undivided interests in certain of our receivables to financial institutions. We entered these agreements at our discretion when we determined that the cost of factoring was less than the cost of servicing our receivables with existing debt. Pursuant to these agreements, we sold \$28 million of receivables during the second quarter of 2008. 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 in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities." A loss in the amount of \$0.3 million related to the sale of receivables is included in selling, general and administrative expense in our consolidated statement of operations for the three and six months ended June 30, 2008.

Our profitability and working capital requirements are seasonal due to the sales mix of Temperature Control products. Our working capital requirements usually peak near the end of the second quarter, as the inventory build-up of air conditioning products is converted to sales and payments on the receivables associated with such sales begin to be received. These increased working capital requirements are funded by borrowings from our lines of credit. We anticipate that our present sources of funds will continue to be adequate to meet our financing needs over the next twelve months. We continue to evaluate alternative sources to further improve the liquidity of our business and to fund the repayment, repurchase or redemption, as the case may be, of the aggregate outstanding amount of our convertible debentures.

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The following is an updated summary of our contractual commitments as of December 31, 2007 to reflect the defeasance of our mortgage loan and new lease agreement relating to our Long Island City, New York facility:

IN THOUSANDS)	2008	2009	2010	2011	2012	2013-2022
Principal payments of						
long term debt (1) .....	\$ 130	\$ 90,149	\$ 126	\$ 119	\$ 119	\$ 21
Operating leases (1) .....	10,272	9,392	6,770	5,731	5,178	21,977
Post retirement benefits ....	5,764	1,021	1,059	1,076	1,110	11,253
Severance payments related to restructuring and integration	2,219	739	311	311	280	1,975
Total commitments..	<u>\$ 18,385</u>	<u>\$101,301</u>	<u>\$ 8,266</u>	<u>\$ 7,237</u>	<u>\$ 6,687</u>	<u>\$ 35,226</u>

- (1) In March 2008, in connection with the closing of the sale of our Long Island City, New York property the remaining balance of the \$7.8 million mortgage loan was defeased and we entered into a lease agreement with the purchaser whereby we would lease space at the property. The initial term of the lease is ten years and contains four 5-year renewal options. During approximately the first twelve months of the lease term, we will make initial annual rent payments of approximately \$2.6 million. Thereafter, we expect to reduce our leased space to 1.5 floors, and the annual rent payments will decrease to approximately \$1.1 million. Refer to Note 4 in the notes to our consolidated financial statements for further details.

### SUMMARY OF SIGNIFICANT 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, 2007. 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.

**REVENUE RECOGNITION** - Revenue is recognized when products are shipped and title has been transferred to a customer, the sales price is fixed and determinable, and collection is reasonably assured. For some of our sales of remanufactured products, we also charge our customers a deposit for the return of a used core

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component which we can use in our future remanufacturing activities. Such deposit is not recognized as revenue but rather carried as a core liability. The liability is extinguished when a core is actually returned to us. We estimate and record provisions for cash discounts, quantity rebates, sales returns and warranties in the period the sale is recorded, based upon our prior experience and current trends. As described below, significant management judgments and estimates must be made and used in estimating sales returns and allowances relating to revenue recognized in any accounting period.

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

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We also evaluate inventories on a regular basis to identify inventory on hand that may be obsolete or in excess of current and future projected market demand. For inventory deemed to be obsolete, we provide a reserve on the full value of the inventory. Inventory that is in excess of current and projected use is reduced by an allowance to a level that approximates our estimate of future demand.

We utilize cores (used parts) in our remanufacturing processes for air conditioning compressors. The production of air conditioning compressors involves the rebuilding of used cores, which we acquire generally either in outright purchases or from returns pursuant to an exchange program with customers. Under such exchange programs, we reduce our inventory, through a charge to cost of sales, when we sell a finished good compressor, and put back to inventory at standard cost through a credit to cost of sales the used core exchanged at the time it is eventually received from the customer.

**SALES RETURNS AND OTHER ALLOWANCES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS** - Management must make estimates of potential future product returns related to current period product revenue. Management analyzes historical returns, current economic trends, and changes in customer demand when evaluating the adequacy of the sales returns and other allowances. Significant management judgments and estimates must be made and used in connection with establishing the sales returns and other allowances in any accounting period. At June 30, 2008, the allowance for sales returns was \$27.4 million. Similarly, management must make estimates of the collectability of our accounts receivables. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. At June 30, 2008, the allowance for doubtful accounts and for discounts was \$10.6 million.

**NEW CUSTOMER ACQUISITION COSTS** - New customer acquisition costs refer to arrangements pursuant to which we incur change-over costs to induce a new customer to switch from a competitor's brand. In addition, change-over costs include the costs related to removing the new customer's inventory and replacing it with our 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



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

Significant management judgment is required in determining the adequacy of our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. At June 30, 2008, we had a valuation allowance of \$26.8 million, due to uncertainties related to our ability to utilize some of our deferred tax assets. The assessment of the adequacy of our valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable.

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

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In accordance with the provisions of SFAS Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No.109," we recognize in our financial statements only those tax positions that meet the more-likely-than-not-recognition threshold. We establish tax reserves for uncertain tax positions that do not meet this threshold. Interest and penalties associated with income tax matters are included in the provision for income taxes in our consolidated statement of operations.

VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL - We assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. With respect to goodwill, we test for impairment at least annually in the fourth quarter of each year as part of our annual budgeting process. 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 of each of our reporting units using the discounted cash flows method and market multiples.

In the event our planning assumptions were modified resulting in impairment to our assets, we would be required to include an expense in our statement of operations, which could materially impact our business, financial condition and results of operations.

RETIREMENT AND POST-RETIREMENT MEDICAL BENEFITS - Each year, we calculate the costs of providing retiree benefits under the provisions of SFAS 87, "Employers' Accounting for Pensions" and SFAS 106, "Employers' Accounting for Post-Retirement Benefits Other than Pensions." The key assumptions used in

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making these calculations are the eligibility criteria of participants, the discount rate used to value the future obligation, and expected return on plan assets. We select discount rates commensurate with current market interest rates on high-quality, fixed-rate debt securities. The expected return on assets is based on our current review of the long-term returns on assets held by the plans, which is influenced by historical averages. Under SFAS Staff Position No.106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," we have concluded that our post-retirement plan is actuarially equivalent to the Medicare Part D benefit and accordingly we recognize subsidies from the federal government in the measurement of the accumulated post-retirement benefit obligation pursuant to the requirements of SFAS 106, "Employers' Accounting for Post-Retirement Benefits Other Than Pensions."

ENVIRONMENTAL RESERVES - We are subject to various U.S. federal and 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.

Our aggregate environmental related accrual as of June 30, 2008 of \$2.2 million declined \$0.2 million from an accrual of \$2.4 million as of March 31, 2008 reflecting the impact of cash payments made during the quarter. The environmental related accrual relates primarily to the Long Island City, New York property. Such estimates may or may not include potential recoveries from insurers or other third parties and 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. We did not incur any environmental remediation expense for the quarter ended June 30, 2008.

ASBESTOS RESERVE - We are responsible for certain future liabilities relating to alleged exposure to asbestos-containing products. In accordance with our accounting policy, our most recent actuarial study as of August 31, 2007 estimated an undiscounted liability for settlement payments, excluding legal costs, ranging from \$23.8 million to \$55.2 million for the period through 2050. As a result, in September 2007 an incremental \$2.8 million provision in our discontinued operation was added to the asbestos accrual increasing the reserve to approximately \$23.8 million as of that date. Based on the information contained in the actuarial study and all other available information considered by us, we concluded that no amount within the range of settlement payments was

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more likely than any other and, therefore, recorded the low end of the range as the liability associated with future settlement payments through 2050 in our consolidated financial statements. In addition, according to the updated study, legal costs, which are expensed as incurred and reported in earnings (loss) from discontinued operation, are estimated to range from \$18.7 million to \$32.6 million during the same period. We plan to perform an annual actuarial analysis during the third quarter of each year for the foreseeable future. Based on this analysis and all other available information, we will continue to reassess the recorded liability and, if deemed necessary, record an adjustment to the reserve, which will be reflected as a loss or gain from discontinued operation. The aforementioned estimated settlement payments and legal costs do not reflect any limited coverage that we may obtain pursuant to an agreement with an insurance carrier for certain asbestos-related claims. See Note 13 of notes to our consolidated financial statements.

OTHER LOSS RESERVES - We have other loss exposures, such as environmental claims, product liability and litigation. Establishing loss reserves for these

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matters requires the use of estimates and judgment of risk exposure and ultimate liability. We estimate losses using consistent and appropriate methods; however, changes to our assumptions could materially affect our recorded liabilities for loss.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

#### FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS 157 is effective for the fiscal year beginning after November 15, 2007, which for us is the year ending December 31, 2008. As of January 1, 2008, we adopted SFAS 157. The adoption of SFAS 157 did not impact our consolidated financial statements in any material respect.

In December 2007, the FASB issued FSP FAS 157-b to defer SFAS 157's effective date for all non-financial assets and liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until years beginning after November 15, 2008. Derivatives measured at fair value under FAS 133 were not deferred under FSP FAS 157-b. We are assessing the impact, if any, which the adoption of FSP FAS 157-b will have on our consolidated financial position, results of operations and cash flows.

#### FAIR VALUE OPTIONS FOR FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), including an amendment of FASB Statement No. 115. SFAS 159 permits an entity to measure certain financial assets and financial liabilities at fair value. The Statement's objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by the measurement of related assets and liabilities using different attributes, without having to apply complex hedge accounting provisions. Entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The new Statement establishes presentation and disclosure requirements to help financial statement users understand the effect of the entity's election on its earnings, but does not eliminate disclosure requirements of other accounting standards. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007, and is effective for us as of January 1, 2008. The adoption of SFAS 159 did not impact our consolidated financial statements in any material respect.

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#### BUSINESS COMBINATIONS

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS 141R also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what

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information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R is effective for the fiscal year beginning after December 15, 2008, which for us is the fiscal year beginning January 1, 2009. SFAS 141R will have an impact on the manner in which we account for future acquisitions beginning in the fiscal year 2009.

### NON-CONTROLLING INTERESTS IN CONSOLIDATED FINANCIAL STATEMENTS

In December 2007, the FASB issued SFAS No. 160, "Non-Controlling Interests in Consolidated Financial Statements - an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a non-controlling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, which for us is the fiscal year beginning January 1, 2009. We are assessing the impact, if any, which the adoption of SFAS 160 will have on our consolidated financial position, results of operations and cash flows.

### DISCLOSURES ABOUT DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," ("SFAS 161"). This Statement requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, which for us is the fiscal year beginning January 1, 2009. We are assessing the impact, if any, which the adoption of SFAS 161 will have on our financial statement disclosures.

### CONVERTIBLE DEBT INSTRUMENTS

In May 2008, the FASB issued FASB Staff Position APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion" ("FSP APB 14-1") which requires issuers of convertible debt that may be settled wholly or partly in cash to account for the debt and equity components separately. This FSP is effective for fiscal years beginning after December 15, 2008, which for us is the fiscal year