STONERIDGE INC
Form 10-K
March 16, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

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

For the transition period from __________ to __________

Commission file number: 001-13337

STONERIDGE, INC.

(Exact name of registrant as specified in its charter)

Ohio	**34-1598949**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
9400 East Market Street, Warren, Ohio	**44484**
(Address of principal executive offices)	*(Zip Code)*

(330) 856-2443

Registrant s telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Shares, without par value	**New York Stock Exchange**

Securities registered pursuant to section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

o Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

o Yes þ No

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. þ Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

As of July 1, 2006, the aggregate market value of the registrant s Common Shares, without par value, held by non-affiliates of the registrant was approximately $112.6 million. The closing price of the Common Shares on June 30, 2006 as reported on the New York Stock Exchange was $8.30 per share. As of July 1, 2006, the number of Common Shares outstanding was 23,225,949.

The number of Common Shares, without par value, outstanding as of February 16, 2007 was 23,804,417.

DOCUMENTS INCORPORATED BY REFERENCE

Definitive Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2007, into Part III, Items 10, 11, 12, 13 and 14.

STONERIDGE, INC. AND SUBSIDIARIES
INDEX

Table of Contents

PART I

Item 1. Business.

Overview

Founded in 1965, Stoneridge, Inc. (the Company) is an independent designer and manufacturer of highly engineered electrical and electronic components, modules and systems for the automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle markets. Our custom-engineered products are predominantly sold on a sole-source basis and consist of application-specific control devices, sensors, vehicle management electronics and power and signal distribution systems. These products comprise the elements of every vehicle s electrical system, and individually interface with a vehicle s mechanical and electrical systems to (i) activate equipment and accessories, (ii) display and monitor vehicle performance and (iii) control and distribute electrical power and signals. Our products improve the performance, safety, convenience and environmental monitoring capabilities of our customers vehicles. As such, the growth in many of the product areas in which we compete is driven by the increasing consumer desire for safety, security and convenience coupled with the need for original equipment manufacturers (OEM) to meet safety requirements in addition to the general trend of increased electrical and electronic content per vehicle. Our technology and our partnership-oriented approach to product design and development enables us to develop next-generation products and to excel in the transition from mechanical-based components and systems to electrical and electronic components, modules and systems.

Products

We conduct our business in two reportable segments: Vehicle Management & Power Distribution and Control Devices. Under the provisions of Statement Financial of Accounting Standard (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*, two of the Company s four operating segments are aggregated into the Vehicle Management & Power Distribution reportable segment and two are aggregated into the Control Devices reportable segment. The core products of the Vehicle Management & Power Distribution reportable segment include vehicle electrical power and distribution systems and electronic instrumentation and information display products. The core products of the Control Devices reportable segment include electronic and electrical switch products, actuator products and sensor products. We design and manufacture the following vehicle parts:

Vehicle Management & Power Distribution. The Vehicle Management & Power Distribution reportable segment produces electronic instrument clusters, electronic control units, and electrical distribution systems, primarily wiring harnesses and connectors for electrical power and signal distribution. These products collect, store and display vehicle information such as speed, pressure, maintenance data, trip information, operator performance, temperature, distance traveled and driver messages related to vehicle performance. In addition, power distribution systems regulate, coordinate and direct the operation of the entire electrical system within a vehicle compartment. These products use state-of-the-art hardware, software and multiplexing technology and are sold principally to the medium- and heavy-duty truck, agricultural and off-highway vehicle markets.

Control Devices. The Control Devices reportable segment produces products that monitor, measure or activate a specific function within the vehicle. Product lines included within the Control Devices segment are sensors, switches, actuators, as well as other electronic products. Sensor products are employed in most major vehicle systems, including the emissions, safety, powertrain, braking, climate control, steering and suspension systems. Switches transmit a signal that activates specific functions. Hidden switches are not typically seen by vehicle passengers, but are used to activate or deactivate selected functions. Customer activated switches are used by a vehicle s operator or passengers to manually activate headlights, rear defrosters and other accessories. In addition, the Control Devices segment designs and manufactures electromechanical actuator products that enable users to deploy power functions in a vehicle and can be designed to integrate switching and control functions. We sell these products principally to the automotive market.

Table of Contents

The following table presents core product lines by reportable segment, as a percentage of net sales:

	For the Fiscal Years Ended December 31,		
	2006	2005	2004
Vehicle Management & Power Distribution:			
Vehicle electrical and power distribution systems	32%	29%	28%
Electronic instrumentation and information display products	25	24	24
Total	57%	53%	52%
Control Devices:			
Actuator and sensor products	18%	21%	20%
Switch and sensor products	25	26	28
Total	43%	47%	48%

For further information related to our reportable segments and financial information about geographic areas, see Note 13, Segment Reporting, to the consolidated financial statements included in this report.

Production Materials

The principal production materials used in the manufacturing process for both reportable segments include: copper wire, cable, resins, plastics, printed circuit boards, metal stamping and certain electrical components such as microprocessors, memories, resistors, capacitors, fuses, relays and connectors. We purchase such materials pursuant to both annual contract and spot purchasing methods. Such materials are readily available from multiple sources, but we generally establish collaborative relationships with a qualified supplier for each of our key production materials in order to lower costs and enhance service and quality. Any change in the supply of, or price for, these raw materials could materially affect our results of operations and financial condition.

Patents and Intellectual Property

Both of our reportable segments maintain and have pending various U.S. and foreign patents and other rights to intellectual property relating to our business, which we believe are appropriate to protect the Company s interests in existing products, new inventions, manufacturing processes and product developments. We do not believe any single patent is material to our business, nor would the expiration or invalidity of any patent have a material adverse effect on our business or ability to compete. We are not currently engaged in any material infringement litigation, nor are there any material infringement claims pending by or against the Company.

Industry Cyclicality and Seasonality

The markets for products in both of our reportable segments have historically been cyclical. Because these products are used principally in the production of vehicles for the automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle markets, sales, and therefore results of operations, are significantly dependent on the general state of the economy and other factors, which affect these markets. A decline in automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle production of our principal customers could adversely impact the Company. Approximately 38%, 43% and 46% of our net sales in 2006, 2005 and 2004, respectively, were made to the automotive market. Approximately 62%, 57% and 54% of our net sales in 2006, 2005 and 2004, respectively, were derived from the medium- and heavy-duty truck, agricultural and off-highway vehicle markets.

We typically experience decreased sales during the third calendar quarter of each year due to the impact of scheduled OEM plant shutdowns in July for vacations and new model changeovers. The fourth quarter is similarly impacted by plant shutdowns for the holidays.

Table of Contents

Customers

We are dependent on a small number of principal customers for a significant percentage of our sales. The loss of any significant portion of our sales to these customers or the loss of a significant customer would have a material adverse impact on the financial condition and results of operations of the Company. We supply numerous different parts to each of our principal customers. Contracts with several of our customers provide for supplying their requirements for a particular model, rather than for manufacturing a specific quantity of products. Such contracts range from one year to the life of the model, which is generally three to seven years. Therefore, the loss of a contract for a major model or a significant decrease in demand for certain key models or group of related models sold by any of our major customers could have a material adverse impact on the Company. We may also enter into contracts to supply parts, the introduction of which may then be delayed or not used at all. We also compete to supply products for successor models and are therefore subject to the risk that the customer will not select the Company to produce products on any such model, which could have a material adverse impact on the financial condition and results of operations of the Company. In addition, we sell products to other customers that are ultimately sold to our principal customers.

The following table presents the Company s principal customers, as a percentage of net sales:

	For the Fiscal Years Ended December 31,		
	2006	2005	2004
Navistar International	25%	22%	21%
DaimlerChrysler	10	12	11
Ford Motor Company	6	7	7
MAN AG	6	2	2
Deere & Company	6	6	6
General Motors	5	5	7
Other	42	46	46
Total	100%	100%	100%

Backlog

Our products are produced from readily available materials and have a relatively short manufacturing cycle; therefore our products are not on backlog status. Each of our production facilities maintains its own inventories and production schedules. Production capacity is adequate to handle current requirements and can be expanded to handle increased growth if needed.

Competition

Markets for our products in both reportable segments are highly competitive. The principle methods of competition are quality, service, price, timely delivery and technological innovation. We compete for new business both at the beginning of the development of new models and upon the redesign of existing models. New model development generally begins two to five years before the marketing of such models to the public. Once a supplier has been selected to provide parts for a new program, an OEM customer will usually continue to purchase those parts from the selected supplier for the life of the program, although not necessarily for any model redesigns.

Our diversity in products creates a wide range of competitors, which vary depending on both market and geographic location. We compete based on strong customer relations and a fast and flexible organization that develops technically effective solutions at or below target price. We compete against the following primary competitors:

Vehicle Management & Power Distribution. Our primary competitors include Alcoa Fujikura, Ametek, Delphi, Sumitomo Electric, Siemens VDO, Visteon and Yazaki.

Control Devices. Our primary competitors include Bosch, Cherry, CTS, Delphi, Denso, Lear, Methode, Sensata and Siemens VDO.

Table of Contents

Product Development

Our research and development efforts are largely product development oriented and consist primarily of applying known technologies to customer generated problems and situations. We work closely with our customers to creatively solve problems using innovative approaches. The vast majority of our development expenses are related to customer-sponsored programs where we are involved in designing custom-engineered solutions for specific applications or for next generation technology. To further our vehicles platform penetration, we have also developed collaborative relationships with the design and engineering departments of key customers. These collaborative efforts have resulted in the development of new and complimentary products and the enhancement of existing products.

Development work at the Company is largely performed on a decentralized basis. We have engineering and product development departments located at a majority of our manufacturing facilities. To ensure knowledge sharing among decentralized development efforts, we have instituted a number of mechanisms and practices whereby innovation and best practices are shared. The decentralized product development operations are complimented by larger technology groups in Canton, Massachusetts and Stockholm, Sweden.

We use efficient and quality oriented work processes to address our customers high standards. Our product development technical resources include a full complement of computer-aided design and engineering (CAD/CAE) software systems, including (i) virtual three-dimensional modeling, (ii) functional simulation and analysis capabilities and (iii) data links for rapid prototyping. These CAD/CAE systems enable the Company to expedite product design and the manufacturing process to shorten the development time and ultimately time to market.

We are further strengthening our electrical engineering competencies through investment in equipment such as (i) automotive electro-magnetic compliance test chambers, (ii) programmable automotive and commercial vehicle transient generators, (iii) circuit simulators and (iv) other environmental test equipment. Additional investment in product machining equipment has allowed us to fabricate new product samples in a fraction of the time required historically. Our product development and validation efforts are supported by full service, on-site test labs at most manufacturing facilities, thus enabling cross-functional engineering teams to optimize the product, process and system performance before tooling initiation.

We have invested, and will continue to invest in technology to develop new products for our customers. Research and development costs incurred in connection with the development of new products and manufacturing methods, to the extent not recoverable from the customer, are charged to selling, general and administrative expenses, as incurred. Such costs amounted to approximately $40.8 million, $39.2 million and $36.1 million for 2006, 2005 and 2004, respectively, or 5.8%, 5.8% and 5.3% of net sales for these periods.

We will shift more of our investment spending toward design and development of new products rather than focusing on sustaining existing product programs for specific customers. This shift is essential to the future growth of the Company. However, the typical product development process takes three to five years to show tangible results. As part of our effort to shift our investment spending, we have reviewed our current product portfolio and we are adjusting our spending to either accelerate or eliminate our investment in these products, based on our position in the market and the potential of the market and product.

Environmental and Other Regulations

Our operations are subject to various federal, state, local and foreign laws and regulations governing, among other things, emissions to air, discharge to waters and the generation, handling, storage, transportation, treatment and disposal of waste and other materials. We believe that our business, operations and facilities have been and are being operated in compliance, in all material respects, with applicable environmental and health and safety laws and regulations, many of which provide for substantial fines and criminal sanctions for violations.

Employees

As of December 31, 2006, we had approximately 6,000 employees, approximately 1,450 of whom were salaried and the balance of whom were paid on an hourly basis. Except for certain employees located in Mexico, Sweden, and the United Kingdom, our employees are not represented by a union. Our unionized workers are not covered by collective bargaining agreements. We believe that relations with our employees are good.

Table of Contents

Joint Ventures

We form joint ventures in order to achieve several strategic objectives including gaining access to new markets, exchanging technology and intellectual capital, broadening our customer base and expanding our product offerings. Specifically we have formed joint ventures in Brazil, PST Indústria Eletrônica da Amazônia Ltda. (PST), and India, Minda Instruments Ltd. (Minda), and continue to explore similar business opportunities in other global markets. We have a 50% interest in PST and a 49% interest in Minda. We entered into our PST joint venture in October 1997 and our Minda joint venture in August 2004. Each of these investments is accounted for using the equity method of accounting.

Our joint ventures have contributed positively to our financial results in 2006 and 2005. In Brazil, our PST joint venture, which serves the vehicle electrical and electronic markets as well as the vehicle security system aftermarket, contributed $6.8 million and $4.0 million of equity earnings in 2006 and 2005, respectively. The increase in earnings at PST was primarily the result of a $23.3 million increase in net sales to $94.1 million in 2006 from $70.8 million in 2005. We also received divided payments of $3.7 million and $2.2 million from PST in 2006 and 2005, respectively. During 2006, we increased our ownership in Minda, which produces electronic instrumentation products for the truck and automotive markets in India, from 20% to 49% for $2.6 million in cash. Minda contributed $0.4 million and $0.1 million of equity earnings in 2006 and 2005, respectively.

Available Information

We make available, free of charge through our website (www.stoneridge.com), our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, and other filings with the Securities and Exchange Commission (SEC), as soon as reasonably practicable after they are filed with the SEC. Our Corporate Governance Guidelines, Code of Business Conduct and Ethics, Code of Ethics for Senior Financial Officers, Whistleblower Policy and Procedures and the charters of the Board s Audit, Compensation and Nominating and Corporate Governance Committees are posted on our website as well. Copies of these documents will be available to any shareholder upon request. Requests should be directed in writing to Investor Relations at 9400 East Market Street, Warren, Ohio 44484.

The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including the Company.

Table of Contents

Item 1A. Risk Factors.

The loss or insolvency of any of our major customers would adversely affect our future results.

We are dependent on a small number of principal customers for a significant percentage of our net sales. In 2006, Navistar International, DaimlerChrysler, Ford Motor Company, MAN AG, Deere & Company and General Motors accounted for 25%, 10%, 6%, 6%, 6% and 5%, respectively, of our net sales. The loss of any significant portion of our sales to these customers or any other significant customers would have a material adverse impact on our results of operations and financial condition. The contracts we have entered into with many of our customers provide for supplying the customers requirements for a particular model, rather than for manufacturing a specific quantity of products. Such contracts range from one year to the life of the model, which is generally three to seven years. These contracts are subject to renegotiation, which may affect product pricing and generally may be terminated by our customers at any time. Therefore, the loss of a contract for a major model or a significant decrease in demand for certain key models or group of related models sold by any of our major customers could have a material adverse impact on our results of operations and financial condition by reducing cash flows and our ability to spread costs over a larger revenue base. We also compete to supply products for successor models and are subject to the risk that the customer will not select us to produce products on any such model, which could have a material adverse impact on our results of operations and financial condition. In addition, we have significant receivable balances related to these customers and other major customers that would be at risk in the event of their bankruptcy.

Our business is cyclical and seasonal in nature and downturns in the automotive, medium- and heavy-duty truck, agricultural and off-road vehicle industries could reduce the sales and profitability of our business.

The demand for our products is largely dependent on the domestic and foreign production of automobiles, medium- and heavy-duty trucks, agricultural and off-road vehicles. The markets for our products have historically been cyclical, because new vehicle demand is dependent on, among other things, consumer spending and is tied closely to the overall strength of the economy. Because our products are used principally in the production of vehicles for the automotive, medium- and heavy-duty truck, agricultural and off-road vehicle markets, our sales, and therefore our results of operations, are significantly dependent on the general state of the economy and other factors which affect these markets. A decline in automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle production could adversely impact our results of operations and financial condition. In 2006, approximately 38% of our net sales were made to the automotive market and approximately 62% were derived from the medium- and heavy-duty truck, agricultural and off-highway vehicle markets. Seasonality experienced by the automotive industry also impacts our operations. We typically experience decreased sales during the third quarter of each year due to the impact of scheduled OEM customer plant shutdowns in July for vacations and new model changeovers. The fourth quarter is also impacted by plant shutdowns for the holidays.

Consolidation among vehicle parts customers and suppliers could make it more difficult for us to compete favorably.

Since the early 1980 s the vehicle part supply industry has undergone a significant consolidation as OEM customers have sought to lower costs, improve quality and increasingly purchase complete systems and modules rather than separate components. As a result of the cost focus of these major customers, we have been, and expect to continue to be, required to reduce prices. Because of these competitive pressures, we cannot assure you that we will be able to increase or maintain gross margins on product sales to our customers. The trend toward consolidation among vehicle parts suppliers is resulting in fewer, larger suppliers who benefit from purchasing and distribution economies of scale. If we cannot achieve cost savings and operational improvements sufficient to allow us to compete favorably in the future with these larger, consolidated companies, our results of operations and financial condition could be adversely affected.

Our physical properties and information systems are subject to damage as a result of disasters, outages or similar events.

Our offices and facilities, including those used for design and development, material procurement, manufacturing, logistics and sales are located throughout the world and are subject to possible destruction, temporary stoppage or disruption as a result of any number of unexpected events. If any of these facilities or offices were to experience a significant loss as a result of any of the above events, it could disrupt our operations, delay production, shipments and revenue, and result in large expenses to repair or replace these facilities or offices.

Table of Contents

In addition, network and information system shutdowns caused by unforeseen events such as power outages, disasters, hardware or software defects, computer viruses and computer hacking pose increasing risks. Such an event could also result in the disruption of our operations, delay production, shipments and revenue, and result in large expenditures necessary to repair or replace such network and information systems.

Our business is very competitive and increased competition could reduce our sales.

Markets for our products are highly competitive and the company can offer no assurance that we can maintain our product pricing levels with our customers. We compete based on quality, service, price, timely delivery and technological innovation. Many of our competitors are more diversified and have greater financial and other resources than we do. We cannot assure you that our business will not be adversely affected by competition or that we will be able to maintain our profitability if the competitive environment changes.

We must implement and sustain a competitive technological advantage in producing our products to compete effectively.

Our products are subject to changing technology, which could place us at a competitive disadvantage relative to alternative products introduced by competitors. Our success will depend on our ability to continue to meet customers changing specifications with respect to quality, service, price, timely delivery and technological innovation by implementing and sustaining competitive technological advances. Our business may, therefore, require, significant ongoing and recurring additional capital expenditures and investment in research and development and manufacturing and management information systems. We cannot assure you that we will be able to achieve the technological advances or introduce new products that may be necessary to remain competitive. Our inability to continuously improve existing products and to develop new products and to achieve technological advances could have a material adverse affect on our results of operations and financial condition.

We may experience increased costs associated with labor unions that could adversely affect our financial performance and results of operations.

As of December 31, 2006, we had approximately 6,000 employees, approximately 1,450 of whom were salaried and the balance of whom were paid on an hourly basis. Certain employees located in Mexico, Sweden, and the United Kingdom are represented by a union but not collective bargaining agreements. We cannot assure you that our employees will not be covered by collective bargaining agreements in the future or that any of our facilities will not experience a work stoppage or other labor disruption. Any prolonged labor disruption involving our employees, employees of our customers, a large percentage of which are covered by collective bargaining agreements, or employees of our suppliers could have a material adverse impact on our results of operations and financial condition by disrupting our ability to manufacture our products or the demand for our products.

Compliance with environmental and other governmental regulations could be costly and require us to make significant expenditures.

Our operations are subject to various federal, state, local and foreign laws and regulations governing, among other things:

- the discharge of pollutants into the air and water;
- the generation, handling, storage, transportation, treatment, and disposal of waste and other materials;
- the cleanup of contaminated properties; and
- the health and safety of our employees.

We believe that our business, operations and facilities have been and are being operated in compliance in all material respects with applicable environmental and health and safety laws and regulations, many of which provide for substantial fines and criminal sanctions for violations. The operation of our manufacturing facilities entails risks and we cannot assure you that we will not incur material costs or liabilities in connection with these operations. In addition, potentially significant expenditures could be required in order to comply with evolving environmental and health and safety laws, regulations or requirements that may be adopted or imposed in the future.

We may incur material product liability costs.

We are subject to the risk of exposure to product liability claims in the event that the failure of any of our products results in personal injury or death and we cannot assure you that we will not experience material product liability losses in the future. In addition, if any of our products prove to be defective, we may be required to participate in government-imposed or OEM-instituted recalls involving such products. We maintain insurance against such product liability claims, but we cannot assure you that such coverage will be adequate for liabilities ultimately incurred or that it will continue to be available on terms acceptable to us. A successful claim brought against us that exceeds available insurance coverage or a requirement to participate in any product recall could have a material adverse affect on our results of operations and financial condition.

We are subject to risks related to our international operations.

Approximately 24% of our net sales in 2006 were derived from sales of our European and other international operations, and European and other international non-current assets accounted for approximately 13% of our non-current assets as of December 31, 2006. International sales and operations are subject to significant risks, including, among others:

- political and economic instability;
- restrictive trade policies;
- economic conditions in local markets;
- currency exchange controls;
- labor unrest;
- difficulty in obtaining distribution support and potentially adverse tax consequences; and
- the imposition of product tariffs and the burden of complying with a wide variety of international and U.S. export laws.

Additionally, to the extent any portion of our net sales and expenses are denominated in currencies other than the U.S. dollar, changes in exchange rates could have a material adverse affect on our results of operations and financial condition.

The prices that we can charge some of our customers are predetermined and we bear the risk of costs in excess of our estimates.

Our supply agreements with some of our customers require us to provide our products at predetermined prices. In some cases, these prices decline over the course of the contract and may require us to meet certain productivity, cost reduction targets. In addition, our customers may require us to share productivity savings in excess of our cost reduction targets. The costs that we incur in fulfilling these contracts may vary substantially from our initial estimates. Unanticipated cost increases or the inability to meet certain cost reduction targets may occur as a result of several factors, including increases in the costs of labor, components or materials. In some cases, we are permitted to pass on to our customers the cost increases associated with specific materials. Cost overruns that we cannot pass on to our customers could adversely affect our business, results of operations and financial condition.

We are dependent on the availability and price of raw materials.

We require substantial amounts of raw materials and substantially all raw materials we require are purchased from outside sources. The availability and prices of raw materials may be subject to curtailment or change due to, among other things, new laws or regulations, suppliers allocations to other purchasers, interruptions in production by suppliers, changes in exchange rates and worldwide price levels. Any change in the supply of, or price for, these raw materials could materially affect our results of operations and financial condition.

Item 1B. Unresolved Staff Comments.

None.

Table of Contents

Item 2. Properties.

The Company and our joint ventures currently own or lease 22 manufacturing facilities, which together contain approximately 1.8 million square feet of manufacturing space. Of these manufacturing facilities, ten are used by our Vehicle Management & Power Distribution reportable segment, nine are used by our Control Devices reportable segment and three are owned by our joint venture companies. The following table provides information regarding our facilities:

Location	Owned/ Leased	Use	Square Footage
Vehicle Management & Power Distribution			
Portland, Indiana	Owned	Manufacturing	182,000
Juarez, Mexico	Owned	Manufacturing/Division Office	178,000
Chihuahua, Mexico	Owned	Manufacturing/Warehouse	135,447
El Paso, Texas	Leased	Warehouse	93,000
Orebro, Sweden	Leased	Manufacturing	77,472
Monclova, Mexico	Leased	Manufacturing	68,436
Orwell, Ohio	Owned	Manufacturing	62,000
Chihuahua, Mexico	Leased	Manufacturing/Warehouse	49,250
Stockholm, Sweden	Leased	Engineering Office/Division Office	41,979
Dundee, Scotland	Leased	Manufacturing/Division Office	30,000
Tallinn, Estonia	Leased	Manufacturing/Office/Warehouse	28,352
Warren, Ohio	Leased	Division Office	24,570
Tallinn, Estonia	Leased	Manufacturing/Warehouse	21,635
Chihuahua, Mexico	Leased	Warehouse	10,000
Bayonne, France	Leased	Sales Office/Warehouse	8,267
Madrid, Spain	Leased	Sales Office/Warehouse	1,560
Stuttgart, Germany	Leased	Sales Office/Engineering Office	1,000
Control Devices			
Lexington, Ohio	Owned	Manufacturing/Division Office	152,742
Canton, Massachusetts	Owned	Manufacturing/Division Office	132,560
Boston, Massachusetts	Owned	Manufacturing/ (Vacant)	130,000
Sarasota, Florida	Owned	Manufacturing/Division Office	115,000
Mitcheldean, England	Leased	Manufacturing/Division Office	74,790
Cheltenham, England	Leased	Manufacturing/ (Vacant)	58,500
Canton, Massachusetts	Leased	Manufacturing	58,077
Suzhou, China	Leased	Manufacturing/Division Office	18,923
Juarez, Mexico	Leased	Warehouse	12,884
Lexington, Ohio	Owned	Manufacturing	10,120
Sarasota, Florida	Owned	Warehouse	7,500
Lexington, Ohio	Leased	Warehouse	5,000
Corporate			
Novi, Michigan	Leased	Sales Office/Engineering Office	9,400
Warren, Ohio	Owned	Headquarters	7,500
Shanghai, China	Leased	Purchasing Office/Sales Office	270
Joint Ventures			
Manaus, Brazil	Owned	Manufacturing/Fabricating/Warehouse	73,550
Pune, India	Owned	Manufacturing/Engineering/Purchasing/Sales/Warehouse	61,000
São Paulo, Brazil	Owned	Manufacturing/Purchasing/Engineering/Sales	38,632

Table of Contents

Item 3. Legal Proceedings.

The Company is involved in certain legal actions and claims arising in the ordinary course of business. The Company, however, does not believe that any of the litigation in which it is currently engaged, either individually or in the aggregate, will have a material adverse effect on its business, consolidated financial position or results of operations. The Company is subject to the risk of exposure to product liability claims in the event that the failure of any of its products causes personal injury or death to users of the Company s products and there can be no assurance that the Company will not experience any material product liability losses in the future. The Company maintains insurance against such product liability claims. In addition, if any of the Company s products prove to be defective, the Company may be required to participate in the government-imposed or OEM customer-instituted recall involving such products.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

Executive Officers of the Company

Each executive officer of the Company is appointed by the Board of Directors, serves at its pleasure and holds office until a successor is appointed, or until the earlier of death, resignation or removal. The Board of Directors generally appoints executive officers annually. The executive officers of the Company are as follows:

Name	Age	Position
John C. Corey	59	President, Chief Executive Officer and Director
George E. Strickler	59	Executive Vice President, Chief Financial Officer and Treasurer
Edward F. Mosel	58	Vice President and President of the Control Devices Division
Thomas A. Beaver	53	Vice President of Global Sales and Systems Engineering
Andrew Mark Oakes	48	Vice President and General Manager of China Operations
Mark J. Tervalon	40	Vice President and President of the Vehicle Management & Power Distribution Division

John C. Corey, President, Chief Executive Officer and Director. Mr. Corey has served as President and Chief Executive Officer since being appointed by the Board of Directors in January 2006. Mr. Corey has served as a Director on the Board of Directors since January 2004. Prior to his employment with the Company, Mr. Corey served from October 2000, as President and Chief Executive Officer and Director of Safety Components International, a supplier of airbags and components, with worldwide operations.

George E. Strickler, Executive Vice President, Chief Financial Officer and Treasurer. Mr. Strickler has served as Executive Vice President and Chief Financial Officer since joining the Company in January of 2006. Mr. Strickler was appointed Treasurer of the Company in February 2007. Prior to his employment with the Company, Mr. Strickler served as Executive Vice President and Chief Financial Officer for Republic Engineered Products, Inc. (Republic), from February 2004 to January of 2006. Before joining Republic, Mr. Strickler was BorgWarner Inc. s Executive Vice President and Chief Financial Officer from February 2001 to November 2003.

Edward F. Mosel, Vice President and President of the Control Devices Division. Mr. Mosel has served as President of the Control Devices Division and Vice President of the Company since August of 2006. Prior to this time, Mr. Mosel served as Vice President of Pollak Sales and Marketing from 1987 to 1993, Vice President and General Manager of Pollak Central Services from 1993 to 1995, Vice President and General Manager of the Switch Products Division from 1996 to 2000, Vice President and General Manager of the Switch and Sensor Products Group from 2001 to 2003, and Executive Vice President and Chief Operating Officer of the Company from 2003 to 2004.

Thomas A. Beaver, Vice President of Global Sales and Systems Engineering. Mr. Beaver has served as Vice President of Global Sales and Systems Engineering of the Company since January of 2005. Prior to this time, Mr. Beaver served as Vice President of Stoneridge Sales and Marketing from January 2000 to January 2005 and Vice President of Sales and Systems Engineering of the Stoneridge Engineered Products Group from February 1995 to December 1999.

Table of Contents

Andrew Mark Oakes, Vice President and General Manager of China Operations. Mr. Oakes has served as Chairman and General Manager of Stoneridge Asia Pacific Electronics (Suzhou) Co., Ltd., a Stoneridge wholly owned subsidiary undergoing start-up in China since September 2005, and in August 2006 he assumed additional duties as Vice President and General Manager of Stoneridge China Business Development and Purchasing Operations. Prior to that, Mr. Oakes served as Vice President and General Manager of the Actuator & Sensor Products Group from 2001 to July 2006 and as General Manager of the Actuator Products Division from 1996 to 2000.

Mark J. Tervalon, Vice President and President of the Vehicle Management & Power Distribution Division. Mr. Tervalon served as President of the Vehicle Management & Power Distribution Division and Vice President of the Company since August of 2006. Prior to that, Mr. Tervalon served as Vice President and General Manager of the Electronic Products Division from May 2002 to December 2003 when he became Vice President and General Manager of the Stoneridge Electronics Group. Mr. Tervalon served as a Vice President and General Manager at Power-One, Inc. from August 1998 to November 2001.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our shares are listed on the New York Stock Exchange (NYSE) under the symbol SRI. As of February 16, 2007, we had 23,804,417 Common Shares without par value, issued and outstanding, which were owned by approximately 300 registered holders, including Common Shares held in the names of brokers and banks (so-called street name holdings) who are record holders with approximately 2,000 beneficial owners.

We have not historically paid or declared dividends, which are restricted under both the senior notes and the credit agreement, on our Common Shares. We may only pay cash dividends in the future if immediately prior to and immediately after the payment is made no event of default has occurred, we remain in compliance with certain leverage ratio requirements, and the amount paid does not exceed 5% of our excess cash flow for the preceding fiscal year. We currently intend to retain earnings for acquisitions, working capital, capital expenditures, general corporate purposes and reduction in outstanding indebtedness. Accordingly, we do not expect to pay cash dividends in the foreseeable future.

High and low sales prices (as reported on the NYSE composite tape) for our Common Shares for each quarter ended during 2006 and 2005 are as follows:

		High	Low
2006	April 1	$ 7.11	$ 4.95
	July 1	$ 8.45	$ 5.60
	September 30	$ 9.89	$ 7.05
	December 31	$ 8.32	$ 6.71
2005	April 2	$15.20	$11.20
	July 2	$12.47	$ 6.10
	October 1	$10.40	$ 6.60
	December 31	$ 8.80	$ 5.95

The Company did not repurchase any Common Shares in 2006 or 2005.

Set forth below is a line graph comparing the cumulative total return of a hypothetical investment in our Common Shares with the cumulative total return of hypothetical investments in the NYSE Market Index and the Hemscott Group-Industry Group 333 (Automotive Parts) Index based on the respective market price of each investment at December 31, 2001, 2002, 2003, 2004, 2005 and 2006, assuming in each case an initial investment of $100 on December 31, 2001, and reinvestment of dividends.

	2001	2002	2003	2004	2005	2006
Stoneridge, Inc.	100.00	130.77	165.38	166.26	72.75	90.00
Hemscott Group Index	100.00	89.18	131.69	135.54	120.5	135.77
NYSE Market Index	100.00	81.69	105.82	119.5	129.37	151.57

For information on Related Stockholder Matters required by Item 201(d) of Regulation S-K, refer to Item 12 of this report.

Table of Contents

Item 6. Selected Financial Data.

The following table sets forth selected historical financial data and should be read in conjunction with the consolidated financial statements and notes related thereto and other financial information included elsewhere herein. The selected historical data was derived from our consolidated financial statements.

	For the Fiscal Years Ended December 31,				
	2006	2005	2004	2003	2002
	(in thousands, except per share data)				
Statement of Operations Data:					
Net sales:					
Vehicle Management & Power Distribution	$ 425,185	$ 375,226	$ 368,625	$ 289,653	$ 273,654
Control Devices	304,804	316,064	331,622	333,051	377,021
Eliminations	(21,290)	(19,706)	(18,452)	(16,039)	(14,168)
Consolidated	$ 708,699	$ 671,584	$ 681,795	$ 606,665	$ 636,507
Gross profit	$ 158,906	$ 148,588	$ 174,987	$ 156,030	$ 165,319
Operating income (loss) (A)	$ 35,063	$ 23,303	$ (125,570)	$ 58,370	$ 74,320
Income (loss) before income taxes and cumulative effect of accounting change (A)					
Vehicle Management & Power Distribution	$ 24,473	$ 13,573	$ 29,623	$ 13,772	$ 9,168
Control Devices	10,396	5,640	(150,021)	48,033	69,366
Other corporate activities	6,392	8,217	(4,477)	(3,644)	(7,344)
Corporate interest	(21,622)	(22,994)	(24,281)	(27,141)	(33,101)
Loss on extinguishment of debt (B)					(5,771)
Consolidated	$ 19,639	$ 4,436	$ (149,156)	$ 31,020	$ 32,318
Income (loss) before cumulative effect of accounting change (C)	$ 14,513	$ 933	$ (92,503)	$ 21,379	$ 21,056
Net income (loss) (C)	$ 14,513	$ 933	$ (92,503)	$ 21,379	$ (48,778)
Basic income (loss) before cumulative effect of accounting change per share	$ 0.63	$ 0.04	$ (4.09)	$ 0.95	$ 0.94
Diluted income (loss) before cumulative effect of accounting change per share	$ 0.63	$ 0.04	$ (4.09)	$ 0.94	$ 0.93

Basic net income (loss) per share	$ 0.63	$ 0.04	$ (4.09)	$ 0.95	$ (2.18)
Diluted net income (loss) per share	$ 0.63	$ 0.04	$ (4.09)	$ 0.94	$ (2.16)
Other Data:					
Product development expenses	$ 40,840	$ 39,193	$ 36,145	$ 28,714	$ 25,332
Capital expenditures	25,895	28,934	23,917	26,382	14,656
Depreciation and amortization (D)	26,180	26,157	24,802	22,188	21,900
Balance Sheet Data (at period end):					
Working capital	$ 135,915	$ 116,689	$ 123,317	$ 72,832	$ 87,112
Total assets	501,807	463,038	473,001	573,001	564,461
Long-term debt, less current portion	200,000	200,000	200,052	200,245	248,918
Shareholders equity	178,622	153,991	155,605	243,406	215,902

Table of Contents

(A) Our 2004 operating loss, loss before income taxes and cumulative effect of accounting change, net loss, and related basic and diluted loss per share amounts include a non-cash, pre-tax goodwill impairment loss of $183,450, which was recorded in the fourth quarter of 2004.

(B) During the second quarter of 2002, the Company recognized a non-cash, pre-tax loss on extinguishment of debt of $5,771, as the result of an early extinguishment of debt.

(C) In accordance with the transition provisions of Statement of Financial Accounting Standard No. 142, *Goodwill and Other Intangible*

Assets, we determined during 2002 that the carrying value of the Company s goodwill exceeded its fair value. Effective January 1, 2002, we recorded a non-cash, after-tax impairment charge of $69,834 as a cumulative effect of accounting change.

(D) These amounts represent depreciation and amortization on fixed and finite-lived intangible assets.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Overview

The following Management Discussion and Analysis (MD&A) is intended to help the reader understand the results of operations and financial condition of the Company. This MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to the financial statements.

We are an independent designer and manufacturer of highly engineered electrical and electronic components, modules and systems for the automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle markets.

Our net income for the year ended December 31, 2006 was $14.5 million, or $0.63 per diluted share, compared with net income of $0.9 million, or $0.04 per diluted share, for 2005.

Our 2006 operating results were favorably affected by a number of items, including improved operational performance at our United Kingdom facility and increased commercial vehicle volumes in North America and Europe. Our results were also favorably impacted by a $4.5 million pretax reduction in our restructuring expense and a $3.5 million pretax reduction in our bad debt expense. Furthermore, our PST Indústria Eletrônica da Amazônia Ltda. (PST) joint venture in Brazil continued to perform well, resulting in equity earnings of $6.8 million compared with $4.0 million in the previous year.

These benefits were mitigated by a number of challenging industry-wide issues, including intense competition, product price reductions, and higher commodity costs. We continuously work to address these challenges by implementing a broad range of initiatives aimed to improve operating performance. During 2006, we employed teams to implement best practices in our underperforming operations and focused our purchasing initiatives to reduce material procurement costs. Our operational improvements and working capital management yielded a $27.4 million increase in cash flow from operating activities increased to $46.5 million and $19.1 million for the fiscal years ended December 31, 2006 and 2005, respectively.

On July 29, 2006 we announced that we would begin work on our second major instrument panel assembly contract for the North American commercial vehicle market. Production is expected to begin in the first quarter of 2007 and the contract is expected to contribute net sales of approximately $40.0 million annually at full production. It is currently anticipated that the program will reach full-production levels by 2009.

In 2007, management expects a significant decline in North American production for medium- and heavy-trucks as more stringent diesel emissions standards become effective in the U.S. We expect our overall sales decline will be less than the industry production decline because our second instrument panel award and stable demand outside the U.S. partially offsets reduced North American medium- and heavy-duty truck production. Our expected performance will be based on our continued drive toward operational excellence across the organization, ongoing cost reduction initiatives and successful launches of several key products in 2007.

Significant factors inherent to our markets that could affect our results for 2007 include the financial stability of our customers and suppliers as well as our ability to successfully execute our planned productivity and cost reduction initiatives. We are undertaking these initiatives to mitigate commodity price increases and customer-demanded price reductions. As part of these programs, we have implemented a nonspeculative hedging program to reduce our exposure to copper price fluctuations. Our results for 2007 also depend on conditions in the automotive and commercial vehicle industries, which are generally dependent on domestic and global economies.

Going forward, we look to continue our transition to low-cost manufacturing locations. Initially, this initiative may result in restructuring costs stemming from facility closures and production relocations. However, the longer-term effects of such an initiative will enable us to reduce our operating costs and provide global sourcing capacity to our customers.

Results of Operations

We are primarily organized by markets served and products produced. Under this organization structure, our operations have been aggregated into two reportable segments: Vehicle Management & Power Distribution and Control Devices. The Vehicle Management & Power Distribution reportable segment includes results of operations from our operations that primarily design and manufacture electronic instrument clusters, electronic control units, driver information systems and electrical

17

distribution systems, primarily wiring harnesses and connectors for electrical power and signal distribution. The Control Devices reportable segment includes results of operations from our operations that primarily design and manufacture electronic and electromechanical switches, control actuation devices and sensors.

Beginning in 2005, we changed from a calendar year-end to a 52-53 week fiscal year-end. Since then, our fiscal quarters were comprised of 13-week periods. On October 30, 2006, we changed back to a calendar (December 31) fiscal year end, and therefore the 2006 fiscal year ended on December 31, 2006. Our fiscal quarters are now comprised of three month periods.

Fiscal Year Ended December 31, 2006 Compared To Fiscal Year Ended December 31, 2005

Net Sales. Net sales for our reportable segments, excluding inter-segment sales, for the fiscal years ended December 31, 2006 and 2005 are summarized in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase /	% Increase /
	2006		2005		(Decrease)	(Decrease)
Vehicle Management & Power Distribution	$ 407,706	57.5%	$ 358,683	53.4%	$ 49,023	13.7%
Control Devices	300,993	42.5	312,901	46.6	(11,908)	(3.8)%
Total net sales	$ 708,699	100.0%	$ 671,584	100.0%	$ 37,115	5.5%

The increase in net sales for our Vehicle Management & Power Distribution segment was primarily due to increased sales to our commercial vehicle customers because North American demand was strong during the year. The most significant factor behind the increase in demand is related to the 2007 implementation of more stringent diesel emissions standards in the U.S. Overall commercial vehicle demand increased in 2006 in anticipation of the 2007 emission changes. As of result of this pull ahead in demand, we expect a substantial decline in North American demand in 2007. In addition to the North American volume increase, our revenues also increased as a result of new product sales in Europe and a $1.4 million impact from foreign currency exchange rates for the year. Net sales for our Control Devices segment declined as a result of lower production volumes at the traditional domestic automakers and product price reductions. These declines were partially offset by new product sales in our European operations. For the full year, the Control Devices segment was impacted by $0.2 million from favorable foreign currency exchange.

Net sales by geographic location for the fiscal years ended December 31, 2006 and 2005 are summarized in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase /	% Increase /
	2006		2005		(Decrease)	(Decrease)
North America	$ 541,541	76.4%	$ 532,523	79.3%	$ 9,018	1.7%
Europe and other	167,158	23.6	139,061	20.7	28,097	20.2%
Total net sales	$ 708,699	100.0%	$ 671,584	100.0%	$ 37,115	5.5%

The increase in North American sales was primarily attributable to increased sales to our commercial vehicle customers as a result of strong North American demand. The increase was substantially offset by unfavorable North American light vehicle production and product price reductions. The increase in sales outside North America was primarily due to new product revenues and favorable foreign currency exchange rates. The favorable effect of foreign currency exchange rates impacted net sales outside North America by $1.6 million for the fiscal year ended December 31, 2006.

Table of Contents

Consolidated statements of operations as a percentage of net sales for the fiscal years ended December 31, 2006 and 2005 are presented in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase /
	2006		2005		(Decrease)
Net Sales	$ 708,699	100.0%	$ 671,584	100.0%	$ 37,115
Costs and Expenses:					
Cost of goods sold	549,793	77.6	522,996	77.9	26,797
Selling, general and administrative	124,302	17.5	116,836	17.4	7,466
Provision for doubtful accounts	236	0.0	3,711	0.6	(3,475)
Gain on sale of property, plant & equipment, net	(1,303)	(0.2)	(360)	(0.1)	(943)
Restructuring charges	608	0.1	5,098	0.7	(4,490)
Operating Income	35,063	5.0	23,303	3.5	11,760
Interest expense, net	21,744	3.1	23,872	3.6	(2,128)
Equity in earnings of investees	(7,125)	(1.0)	(4,052)	(0.6)	(3,073)
Other (income) loss, net	805	0.1	(953)	(0.1)	1,758
Income Before Income Taxes	19,639	2.8	4,436	0.6	15,203
Provision for income taxes	5,126	0.7	3,503	0.5	1,623
Net Income	$ 14,513	2.1%	$ 933	0.1%	$ 13,580

Cost of Goods Sold. This decrease in cost of goods sold as a percentage of sales was predominately due to operational improvements and increased sales volume. Offsetting these factors were unfavorable material price variances resulting from raw material price increases and product price reductions. We expect that pricing and raw material price challenges will continue to affect our gross margin into 2007. Our management team is working to offset these pressures through our focused operational improvement efforts, commodity hedging and purchasing programs.

Selling, General and Administrative Expenses. The increase in non-product development SG&A expenses in 2006 compared with 2005 is primarily attributable to the increase in sales and infrastructure costs related to a new product launch and costs related to a consulting agreement for a former employee. These increases were partially offset by a $1.2 million one-time gain related to the settlement of the life insurance benefits portion of a postretirement benefit plan. During 2005, our SG&A costs benefited from non-recurring legal and commercial settlements. Product development expenses included in selling, general and administrative (SG&A) were $40.8 million and $39.2 million for the fiscal years ended December 31, 2006 and 2005, respectively. In the future, the company intends to reallocate its resources to focus on the design and development of new products rather than focusing on sustaining existing product programs for specific customers.

Provision for Doubtful Accounts. The decrease in the provision for doubtful accounts was primarily a function of bad debt charges associated with customer bankruptcies in 2005 exceeding the bad debt charges associated with customer bankruptcies in 2006.

Restructuring Charges. In January 2005, we announced that we would undertake restructuring efforts related to the rationalization of certain manufacturing facilities in Europe and North America. The restructuring is a result of our cost reduction initiatives. The decrease in restructuring charges was a result of the substantial completion of our previously announced restructuring initiatives.

Interest Expense, Net. The decrease in interest expense, net was primarily due to an increase in interest income in 2006. Interest income in 2006 and 2005 was $2.9 million and $0.9 million, respectively. This increase was related to a

$1.2 million past due interest payment from PST and increased interest generated from our cash and cash equivalents.

Equity in Earnings of Investees. The increase in equity in earnings of investees was predominately attributable to the increase in equity earnings recognized from our PST joint venture in Brazil. The increase primarily reflects higher volume for PST s security and electric power component product lines.

Other (Income) Loss, Net. The decrease in other income was primarily the result of unfavorable foreign exchange contract variances. The decrease was offset by a $1.6 million gain on the sale of our partnership interest in Industrial Development Associates (IDA).

Income Before Income Taxes. Income before income taxes is summarized in the following table by reportable segment (in thousands)

	For the Fiscal Years Ended December 31, 2006	2005	$ Increase / (Decrease)
Vehicle Management & Power Distribution	$ 24,473	$ 13,573	$ 10,900
Control Devices	10,396	5,640	4,756
Other corporate activities	6,392	8,217	(1,825)
Corporate interest expense	(21,622)	(22,994)	1,372
Income before income taxes	$ 19,639	$ 4,436	$ 15,203

The increase in income before income taxes at the Vehicle Management & Power Distribution reportable segment was primarily the result of increased sales volume, a reduction in bad debt expense, and operational improvements. Offsetting these gains were unfavorable raw material purchase price variances and product price reductions.

The increase in income before income taxes at the Control Devices reportable segment was primarily the result of improved operating efficiencies at our United Kingdom operation and a reduction in restructuring and bad debt expenses. These factors were partially offset by ongoing product price reductions and increased raw material costs.

Income before income taxes by geographic location for the fiscal years ended December 31, 2006 and 2005 are summarized in the following table (in thousands):

	For the Fiscal Years Ended December 31, 2006		2005		$ Increase / (Decrease)	% Increase / (Decrease)
North America	$ 10,847	55.2%	$ 7,208	162.5%	$ 3,639	50.5%
Europe and other	8,792	44.8	(2,772)	(62.5)	11,564	417.2%
Income before income taxes	$ 19,639	100.0%	$ 4,436	100.0%	$ 15,203	342.7%

The increase in our profitability in North America was primarily attributable to increased North American commercial vehicle volume and lower bad debt expenses. The positive variance was partially offset by unfavorable raw material variances and product price reductions. The increase in our profitability outside North America was primarily due to the operational improvement at our United Kingdom operations, which experienced significant operational inefficiencies in 2005, and increased sales volume. These improvements were partially offset by costs related to the start-up of our Suzhou, China, manufacturing facility.

Provision (Benefit) for Income Taxes. We recognized a provision for income taxes of $5.1 million, or 26.1% of pre-tax income, and $3.5 million, or 79.0% of the pre-tax income, for federal, state and foreign income taxes for the years ended December 31, 2006 and 2005, respectively. The decrease in the effective tax rate was primarily attributable to an increase in pre- tax earnings and a corresponding reduction in the amount of additional valuation allowance needed that resulted from the improved performance of our United Kingdom operations.

Table of Contents

Fiscal Year Ended December 31, 2005 Compared To Fiscal Year Ended December 31, 2004

Net Sales. Net sales for our reportable segments, excluding inter-segment sales, for the fiscal years ended December 31, 2005 and 2004 are summarized in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase /	% Increase /
	2005		2004		(Decrease)	(Decrease)
Vehicle Management & Power Distribution	$ 358,683	53.4%	$ 352,706	51.7%	$ 5,977	1.7%
Control Devices	312,901	46.6	329,089	48.3	(16,188)	(4.9)%
Total net sales	$ 671,584	100.0%	$ 681,795	100.0%	$ (10,211)	(1.5)%

The increase in net sales for our Vehicle Management & Power Distribution reportable segment was primarily due to increased North American commercial vehicle production, mitigated by product price reductions and a European product phase-out. The decrease in net sales for our Control Devices reportable segment during the fiscal year 2005 was primarily attributable to product price reductions and reduced North American light vehicle production for our customers.

Net sales by geographic location for the fiscal years ended December 31, 2005 and 2004 are summarized in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase /	% Increase /
	2005		2004		(Decrease)	(Decrease)
North America	$ 532,523	79.3%	$ 539,412	79.1%	$ (6,889)	(1.3)%
Europe and other	139,061	20.7	142,383	20.9	(3,322)	(2.3)%
Total net sales	$ 671,584	100.0%	$ 681,795	100.0%	$ (10,211)	(1.5)%

The decrease in sales outside North America was primarily attributed to lower light vehicle volume and a product phase-out. The decrease was partially offset by increased commercial vehicle production. The decline in North American sales is attributable to reduced light vehicle volumes and price reductions.

Consolidated statements of operations as a percentage of net sales for the fiscal years ended December 31, 2005 and 2004 are presented in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase /
	2005		2004		(Decrease)
Net Sales	$ 671,584	100.0%	$ 681,795	100.0%	$ (10,211)
Costs and Expenses:					
Cost of goods sold	522,996	77.9	506,808	74.3	16,188
Selling, general and administrative	116,836	17.4	114,480	16.8	2,356
Provision for doubtful accounts	3,711	0.6	354	0.1	3,357
(Gain) loss on sale of property, plant and equipment, net	(360)	(0.1)	186	0.0	(546)
Goodwill impairment charge			183,450	26.9	(183,450)
Restructuring charges	5,098	0.7	2,087	0.3	3,011

Operating Income (loss)		23,303	3.5		(125,570)	(18.4)		148,873
Interest expense, net		23,872	3.6		24,456	3.6		(584)
Equity in earnings of investees		(4,052)	(0.6)		(1,698)	(0.2)		(2,354)
Other (income) loss, net		(953)	(0.1)		828	0.1		(1,781)
Income (Loss) Before Income Taxes		4,436	0.6		(149,156)	(21.9)		153,592
Provision for income taxes		3,503	0.5		(56,653)	(8.3)		60,156
Net Income (Loss)	$	933	0.1%	$	(92,503)	(13.6)%	$	93,436

21

Cost of Goods Sold. This increase in cost of goods sold as a percentage of sales was predominately due to operational inefficiencies resulting from the execution of our restructuring efforts, price reductions and reduced North American light vehicle volume.

Selling, General and Administrative Expenses. Included in SG&A expenses for the fiscal year ended December 31, 2005 and 2004 were product development expenses of $39.2 million and $36.1 million, respectively. The increase in SG&A expenses primarily reflects increased investment in our product development activities, which are focused on driver information products, emissions system products, chassis and occupant safety. The increase also reflects increased sales and marketing activity partially offset by decreased Sarbanes-Oxley compliance expenses.

Provision for Doubtful Accounts. The increase in the provision for doubtful accounts was primarily a function of bad debt charges associated with customer bankruptcies in 2005 exceeding the bad debt charges associated with customer bankruptcies in 2004.

Restructuring Charges. The increase in restructuring charges was a result of our restructuring initiatives announced in January 2005 that we would undertake restructuring efforts related to the rationalization of certain manufacturing facilities in the high cost regions of Europe and North America. This rationalization was a result of our cost reduction initiatives.

Equity in Earnings of Investees. The increase in equity earnings from investees was predominately attributable to the increase in equity earnings recognized from our PST joint venture in Brazil. The increase primarily reflects higher volume and pricing for PST s security product lines.

Other (Income) Loss, Net. The increase in other income was primarily the result of favorable foreign currency forward and option contracts.

Income (Loss) Before Income Taxes. Income (loss) before income taxes, which is the primary profitability measure used by our chief executive officer, is summarized in the following table by reportable segment for the fiscal years ended December 31, 2005 and 2004 (in thousands):

	For the Fiscal Years Ended December 31,		**$ Increase /**
	2005	**2004**	**(Decrease)**
Vehicle Management & Power Distribution	$ 13,573	$ 29,623	$ (16,050)
Control Devices	5,640	(150,021)	155,661
Other corporate activities	8,217	(4,477)	12,694
Corporate interest expense	(22,994)	(24,281)	1,287
Income (loss) before income taxes	$ 4,436	$ (149,156)	$ 153,592

The decrease in income (loss) before income taxes at the Vehicle Management & Power Distribution reportable segment was primarily the result of operational inefficiencies, bad debt expenses related to customer bankruptcies, increased product development expenses, restructuring charges and product price reductions. Customer bankruptcies resulted in a charge of $1.0 million in 2005 for the Vehicle Management & Power Distribution reportable segment.

The increase in income (loss) before income taxes at the Control Devices reportable segment was primarily the result of the $183.5 million goodwill impairment charge recorded in 2004 that did not recur in 2005. Excluding this charge, income declined year-over-year due to operational inefficiencies, product price reductions, decreased North American light vehicle volume, and a $2.6 million charge related to customer bankruptcies.

Table of Contents

Income before income taxes by geographic location for the fiscal years ended December 31, 2005 and 2004 is summarized in the following table (in thousands):

	For the Fiscal Years Ended December 31,				$ Increase / (Decrease)	% Increase / (Decrease)
	2005		2004			
North America	$ 7,208	162.5%	$ (157,868)	105.8%	$ 165,076	104.6%
Europe and other	(2,772)	(62.5)	8,712	(5.8)	(11,484)	(131.8)%
Income (loss) before income taxes	$ 4,436	100.0%	$ (149,156)	100.0%	$ 153,592	103.0%

The decrease in our overall profitability, excluding the goodwill impairment charge recorded in 2004, was primarily due to operating inefficiencies, restructuring charges, customer bankruptcies, product price reductions, and increased product development activities.

Provision (Benefit) for Income Taxes. We recognized a provision (benefit) for income taxes of $3.5 million, or 79% of pre-tax income, and $(56.7) million, or (38%) of the pre-tax loss, for federal, state and foreign income taxes for the fiscal years ended December 31, 2005 and 2004, respectively. The increase in the effective rate for the fiscal year ended December 31, 2005 compared to 2004 was attributable to net operating loss carryforwards and certain other deferred tax assets in the United Kingdom that required a full valuation allowance in 2005.

Liquidity and Capital Resources

Net cash provided by operating activities was $46.5 million and $19.1 million for the fiscal years ended December 31, 2006 and 2005, respectively. The increase in net cash provided by operating activities of $27.4 million was primarily due to improvements in net income and lower working capital levels. Our cash management strategy of better matching our suppliers terms with our customers terms increased our accounts payable balance and resulted in increased cash flows for 2006.

Net cash used by investing activities was $24.6 million and $27.6 million for the fiscal years ended December 31, 2006 and 2005, respectively. The decrease in net cash used by investing activities of $3.0 million was attributable to a decrease in capital expenditures during the year. During 2006, major capital spending initiatives included the launch of new products in the areas of customer-actuated switches, power distribution systems and sensor products. We also invested approximately $2.6 million for an additional 29% stake in our Minda Instruments Limited (Minda) joint venture, increasing our investment in Minda from 20% to 49%. In 2006, capital and investment spending was offset by $2.3 million in proceeds from a property sale and $1.2 million in proceeds from the sale of our partnership interest in IDA.

Net cash provided (used) by financing activities was $0.1 million and $(0.4) million for the fiscal years ended December 31, 2006 and 2005, respectively. Cash provided by financing activities for the year ended December 31, 2006 was primarily related to proceeds from the exercise of share options, partially offset by cash used for fees related to the completion of our credit agreement amendment during the first quarter. See Note 4 to the Company s consolidated financial statements for further information on the Company s senior notes and credit facilities.

As discussed in Note 9 to our consolidated financial statements, we have entered into foreign currency forward contracts with a notional value of $16.1 million and $23.0 million at December 31, 2006 and 2005, respectively. The purpose of these investments is to reduce exposure related to our krona- and pound-denominated receivables. The estimated fair value of these contracts at December 31, 2006 and 2005, per quoted market sources, was approximately $(0.5) million and $0.2 million, respectively. The Company s foreign currency option contracts were expired as of December 31, 2006 and 2005, respectively. As discussed in Note 9, we have entered into a fixed price swap for 480 metric tonnes of copper. The purpose of these contracts is to reduce our price risk as it relates to copper prices. As of December 31, 2006, the change in value of the commodity swaps was approximately $(0.1) million.

Our credit facilities contain various covenants that require, among other things, the maintenance of certain specified ratios of consolidated total debt to consolidated EBITDA, interest coverage and fixed charge coverage.

Restrictions also include limits on capital expenditures, operating leases and dividends. We were in compliance with all covenants at December 31, 2006. On March 7, 2006, we amended our credit agreement dated May 1, 2002. The amendment modifies certain financial covenant requirements, changes certain reporting requirements, sets borrowing levels based on certain asset levels and prohibits us from repurchasing, repaying or redeeming any of our outstanding subordinated notes unless certain covenant levels are met. See Note 4 to the Company s consolidated financial statements for further information on the Company s senior notes and credit facilities.

The following table summarizes our future cash outflows resulting from financial contracts and commitments, as of December 31, 2006 (in thousands).

Contractual Obligations:	Total	Less than 1 year	2-3 years	4-5 years	After 5 years
Long-term debt	$ 200,000	$	$	$	$ 200,000
Operating leases	17,839	5,737	6,499	1,493	4,110
Employee benefit plans	9,988	763	1,527	1,835	5,863
Total contractual obligations	$ 227,827	$ 6,500	$ 8,026	$ 3,328	$ 209,973

The Company s $200.0 million senior notes are redeemable in May 2007 at 105.75. Given the Company s senior notes are redeemable in the near future, we may seek to retire the notes through cash purchases, open market purchases, privately negotiated transactions or otherwise. Such redemptions, purchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

Future capital expenditures are expected to be consistent with recent levels and future organic growth is expected to be funded through cash flows from operations. Management will continue to focus on reducing its weighted average cost of capital and believes that cash flows from operations and the availability of funds from our credit facilities will provide sufficient liquidity to meet our future growth and operating needs. As outlined in Note 4 to our consolidated financial statements, the Company is party to a $100.0 million revolving credit facility. On March 7, 2006, the Company amended the credit agreement, which, among other things, gave the Company substantially all of its borrowing capacity on the $100.0 million credit facility. As of December 31, 2006, $96.7 million of the $100.0 million was available.

Inflation and International Presence

Given the current economic climate and recent increases in certain commodity prices, we believe that a continuation of such price increases would significantly affect our profitability. Furthermore, by operating internationally, we are affected by the economic conditions of certain countries. Based on the current economic conditions in these countries, we believe we are not significantly exposed to adverse economic conditions.

Critical Accounting Policies and Estimates

Estimates. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period.

On an ongoing basis, we evaluate estimates and assumptions used in our financial statements. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates.

We believe the following are critical accounting policies those most important to the financial presentation and those that require the most difficult, subjective or complex judgments.

Revenue Recognition and Sales Commitments. We recognize revenues from the sale of products, net of actual and estimated returns of products sold based on authorized returns and historical trends in sales returns, at the point of passage of title, which is generally at the time of shipment. We often enter into agreements with our customers at the beginning of a given vehicle s expected production life. Once such agreements are entered into, it is our obligation to fulfill the customers purchasing requirements for the entire production life of the vehicle. These agreements are subject to renegotiation, which may affect product pricing. In certain limited instances, we may be committed under existing agreements to supply products to our customers at selling prices which are not sufficient to cover the direct cost to produce such products. In such situations, we recognize losses immediately. These agreements generally may also be terminated by our customers at any time.

On an ongoing basis, we receive blanket purchase orders from our customers, which include pricing terms. Purchase orders do not always specify quantities. We recognize revenue based on the pricing terms included in our purchase orders as our products are shipped to our customers. We are asked to provide our customers with annual cost reductions as part of certain agreements. In addition, we have ongoing adjustments to our pricing arrangements with our customers based on the related content, the cost of our products and other commercial factors. Such pricing accruals are adjusted as they are settled with our customers.

Warranties. Our warranty reserve is established based on our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet dates. This estimate is based on historical trends of units sold and payment amounts, combined with our current understanding of the status of existing claims. To estimate the warranty reserve, we are required to forecast the resolution of existing claims as well as expected future claims on products previously sold. Although, we believe that our warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable could differ materially from what will actually transpire in the future. Our customers are increasingly seeking to hold suppliers responsible for product warranties, which could negatively impact our exposure to these costs.

Allowance for Doubtful Accounts. We have concentrations of sales and trade receivable balances with a few key customers. Therefore, it is critical that we evaluate the collectibility of accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer s inability to meet their financial obligations, a specific allowance for doubtful accounts is recorded against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected. Additionally, we review historical trends for collectibility in determining an estimate for our allowance for doubtful accounts. If economic circumstances change substantially, estimates of the recoverability of amounts due to the Company could be reduced by a material amount. We do not have collateral requirements with our customers.

Contingencies. We are subject to legal proceedings and claims, including product liability claims, commercial or contractual disputes, environmental enforcement actions and other claims that arise in the normal course of business. We routinely assess the likelihood of any adverse judgments or outcomes to these matters, as well as ranges of probable losses, by consulting with internal personnel principally involved with such matters and with our outside legal council handling such matters.

We have accrued for estimated losses in accordance with Statement of Financial Accounting Standard (SFAS) No. 5, *Accounting for Contingencies*, when it is probable that a liability or loss has been incurred and the amount can be reasonably estimated. Contingencies by their nature relate to uncertainties that require the exercise of judgment both in assessing whether or not a liability or loss has been incurred and estimated that amount of probable loss. The reserves may change in the future due to new developments or changes in circumstances. The inherent uncertainty related to the outcome of these matters can result in amounts materially different from any provisions made with respect to their resolution.

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

Goodwill. In connection with the adoption of SFAS No. 142, *Goodwill and Other Intangible Assets*, we discontinued the amortization of goodwill on January 1, 2002. In lieu of amortization, this standard requires that goodwill be tested for impairment at least annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The valuation methodologies employed by the Company use subjective measures including forward looking financial information and discount rates that directly impact the resulting fair values used to test the Company s business units for impairment. See Note 2 to our consolidated financial statements for more information on our application of this accounting standard, including the valuation techniques used to determine the fair value of goodwill.

Share-Based Compensation. The valuing of our share-based compensation awards involves a number of assumptions. We believe each assumption used in the valuation is reasonable because it takes into account the experience of the plan and reasonable expectations. We estimate volatility and forfeitures based on historical data and the expected term of the share-based compensation awards. The assumptions, however, involve inherent uncertainties. As a result, if other assumptions had been used, share-based compensation expense could have varied.

Pension and Other Postretirement Benefits. The amounts recognized in the consolidated financial statements related to pension and other postretirement benefits are determined from actuarial valuations. Inherent in these valuations are assumptions including expected return on plan assets, discount rates at which the liabilities could be settled at December 31, 2006, rate of increase in future compensation levels, mortality rates and health care cost trend rates. These assumptions are updated annually and are disclosed in Note 8 to the consolidated financial statements. In accordance with U.S. GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, affect expense.

The expected long-term return on assets is determined as a weighted average of the expected returns for each asset class held by the defined-benefit pension plan at the date. The expected return on bonds has been based on the yield available on similar bonds (by currency, issuer and duration) at that date. The expected return on equities is based on an equity risk premium of return above that available on long-term government bonds of a similar duration and the same currency as the liabilities.

Discount rates for our defined benefit pension plan in the United Kingdom are determined using the average long-term sterling AA corporate bond. On December 29, 2006, the yield was approximately 5.15%, with the individual yields on most of these yields of most of the bonds being within a range of 5.0% 5.4%.

Discount rates for our other postretirement benefit plan in the U.S. are determined using the Moody s Aa Corporate Bond Index. The average equivalent annual rate on a Aa Corporate bond at December 31, 2006 was 5.8%.

Deferred Income Taxes. Deferred income taxes are provided for temporary differences between amounts of assets and liabilities for financial reporting purposes and the basis of such assets and liabilities as measured by tax laws and regulations. Our deferred tax assets include net operating loss carryforwards and tax credits that can be used to offset taxable income in future periods and reduce income taxes payable in those future periods. Due to the length of the carryover period it is unlikely that the deferred tax assets will expire prior to being utilized. The Company does not provide deferred income taxes on unremitted earnings of certain non-U.S. subsidiaries, which are deemed permanently reinvested.

SFAS No. 109, *Accounting for Income Taxes*, requires that deferred tax assets be reduced by a valuation allowance if, based on all available evidence, it is considered more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. This assessment requires significant judgment, and in making this evaluation, the Company considers available positive and negative evidence, including past results, the existence of cumulative losses in recent periods, and our forecast of taxable income for the current year and future years. A valuation allowance may need to be recorded against U.S. deferred tax assets in the event that future U.S. taxable income is materially different than estimated amounts. The primary risk factor is a more than expected severe downturn in the U.S. automotive and commercial vehicle segments of which the Company has significant U.S. operations. The impact of the risk factor would be offset by raw material cost management and restructuring initiatives which are expected to result in savings in future periods.

Recently Issued Accounting Standards

New accounting standards to be implemented:

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides criteria for subsequently recognizing, derecognizing and measuring changes in uncertain tax positions and requires expanded disclosures with respect to the uncertainty of income taxes. The accounting provisions of FIN 48 will be effective for the Company beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We are currently reviewing this new standard to determine its effects, if any, on our results of operations or financial position.

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), *Fair Value Measurements*, which provides a definition of fair value, establishes a framework for measuring fair value and requires expanded disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after

November 15, 2007, and interim periods

26

within those years. The provisions of SFAS 157 will be applied prospectively. We are currently evaluating the impact SFAS 157 will have on our financial statements.

New accounting standards implemented:

In September 2006, the FASB issued FASB Staff Position (FSP) No. AUG AIR-1 (FSP No. AUG AIR-1), *Accounting for Planned Major Maintenance Activities*. This position prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. The provisions of the pronouncement are effective for fiscal years beginning after December 15, 2006. We adopted the provisions of this FSP as of January 1, 2007, as required. The adoption did not have a material impact on our consolidated results of operations or financial condition.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,* which expresses the SEC s views regarding the process of quantifying financial statement misstatements. Registrants are required to quantify the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. The financial statements would require adjustment when either approach results in quantifying a misstatement that is material, after considering all relevant quantitative and qualitative factors. SAB 108 is effective for financial statements covering the first fiscal year ending after November 15, 2006. The adoption of SAB 108 did not have an impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158 (SFAS 158), *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(*R). This statement requires an entity to recognize the funded status of its defined benefit pension plans and other postretirement benefit plans, such as a retiree health care plan, on the balance sheet and to recognize changes in the funded status, that arise during the period but are not recognized as components of net periodic benefit cost, within other comprehensive income, net of income taxes. SFAS 158 also requires measurement of the funded status of the plans as of the balance sheet date. SFAS 158 is effective for recognition of the funded status of the plans for fiscal years ending after December 15, 2006 and is effective for the measurement date provisions for fiscal years ending after December 15, 2008. Upon adoption of SFAS 158, there was no significant impact on our consolidated statement of financial position.

Forward-Looking Statements

Portions of this report contain forward-looking statements under the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this report and include statements regarding the intent, belief or current expectations of the Company, our directors or officers with respect to, among other things, our (i) future product and facility expansion, (ii) acquisition strategy, (iii) investments and new product development, and (iv) growth opportunities related to awarded business. Forward-looking statements may be identified by the words will, may, designed to, believes, plans, expects, continue, and similar words and expressions. The forward-looking statements in this report are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, among other factors:

- the loss or bankruptcy of a major customer;
- the costs and timing of facility closures, business realignment, or similar actions;
- a significant change in automotive, medium- and heavy-duty or agricultural and off-highway vehicle production;
- our ability to achieve cost reductions that offset or exceed customer-mandated selling price reductions;
- a significant change in general economic conditions in any of the various countries in which we operate;
- labor disruptions at our facilities or at any of our significant customers or suppliers;

the ability of our suppliers to supply us with parts and components at competitive prices on a timely basis;

the amount of debt and the restrictive covenants contained in our credit facility;

customer acceptance of new products;

capital availability or costs, including changes in interest rates or market perceptions;

the successful integration of any acquired businesses;

the occurrence or non-occurrence of circumstances beyond our control; and

those items described in Part I, Item IA (Risk Factors).

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

From time to time, we are exposed to certain market risks, primarily resulting from the effects of changes in interest rates. At December 31, 2006, however, all of our debt was fixed rate debt. At this time, we do not use financial instruments to manage this risk.

Commodity Price Risk

Given the current economic climate and the recent increases in certain commodity costs, we currently are experiencing an increased risk, particularly with respect to the purchase of copper, zinc, resins and certain other commodities. We manage this risk through a combination of fixed price agreements, staggered short-term contract maturities and commercial negotiations with our suppliers. In December 2006, we entered into a fixed price swap for 480 metric tonnes of copper. The purpose of these contracts is to reduce our price risk as it relates to copper prices. The recent increases in certain commodity costs have negatively affected our operating results, and a continuation of such price increases could significantly affect our profitability. Going forward, we believe that our mitigation efforts will offset a substantial portion of the financial impact of these increased costs. However, no assurances can be given that the magnitude or duration of these increased costs will not have a material impact on our future operating results. A hypothetical pre-tax gain or loss in fair value from a 10.0% favorable or adverse change in commodity prices would not significantly affect our results of operations, financial position or cash flows.

Foreign Currency Exchange Risk

Our risks related to foreign currency exchange rates have historically not been material; however, given the current economic climate, we are monitoring this risk. We use derivative financial instruments, including foreign currency forward and option contracts, to mitigate our exposure to fluctuations in foreign currency exchange rates by reducing the effect of such fluctuations on foreign currency denominated intercompany transactions and other known foreign currency exposures. As discussed in Note 9 to our consolidated financial statements, we have entered into foreign currency forward contracts that had a notional value of $16.1 million and $23.0 million at December 31, 2006 and 2005, respectively. The purpose of these investments is to reduce exposure related to the Company s Swedish krona and British pound denominated receivables. The estimated fair value of these contracts at December 31, 2006 and 2005, per quoted market sources, was approximately $(0.5) million and $0.2 million, respectively. The Company s foreign currency option contracts expired as of December 31, 2006. We do not expect the effects of this risk to be material in the future based on the current operating and economic conditions in the countries in which we operate.

A hypothetical pre-tax gain (loss) in fair value from a 10% favorable or adverse change in quoted currency exchange rates would be approximately $1.5 million or $(1.8) million as of December 31, 2006. A hypothetical pre-tax gain (loss) in fair value from a 10% favorable or adverse change in quoted currency exchange rates would be approximately $2.1 million or $(2.5) million as of December 31, 2005. These estimated changes assume a parallel shift in all currency exchange rates and include the gain or loss on financial instruments used to hedge known foreign currency exposures. Because exchange rates typically do not all move in the same direction, the estimate may overstate the impact of changing exchange rates on the net fair value of the Company s currency derivatives. It is also important to note that gains and losses indicated in the sensitivity analysis would generally be offset by gains and losses on the underlying exposures being hedged. Therefore, a hypothetical pre-tax gain or loss in fair value from a 10.0% favorable or adverse change in quoted foreign currencies would not significantly affect our results of operations, financial position or cash flows.

Table of Contents

Item 8. Financial Statements and Supplementary Data.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders of Stoneridge, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Stoneridge, Inc. and Subsidiaries as of December 31, 2006 and 2005 and the related consolidated statements of operations, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audit also included the financial statement schedule listed in the Index at Item 15. These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Stoneridge, Inc. and Subsidiaries at December 31, 2006 and 2005 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, effective at the beginning of the second quarter of 2005, the Company adopted FASB Statement No. 123 (revised 2004), Share-Based Payment (FAS 123(R)) using the modified-prospective-transition method.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Stoneridge, Inc. and Subsidiaries internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 12, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Cleveland, Ohio
March 12, 2007

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

	December 31, 2006	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 65,882	$ 40,784
Accounts receivable, less allowances for doubtful accounts of $3,831 and $3,829, respectively	106,985	100,362
Inventories, net	58,521	53,791
Prepaid expenses and other	13,448	14,490
Deferred income taxes	9,196	9,253
Total current assets	254,032	218,680
Long-Term Assets:		
Property, plant and equipment, net	114,586	113,478
Other Assets:		
Goodwill	65,176	65,176
Investments and other, net	30,875	26,491
Deferred income taxes	37,138	39,213
Total long-term assets	247,775	244,358
Total Assets	$ 501,807	$ 463,038
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Current portion of long-term debt	$	$ 44
Accounts payable	72,493	55,344
Accrued expenses and other	45,624	46,603
Total current liabilities	118,117	101,991
Long-Term Liabilities:		
Long-term debt, net of current portion	200,000	200,000
Deferred income taxes	1,923	923
Other liabilities	3,145	6,133
Total long-term liabilities	205,068	207,056

Shareholders Equity:		
Preferred Shares, without par value, authorized 5,000 shares, none issued		
Common Shares, without par value, authorized 60,000 shares, issued 23,990 and 23,232 shares and outstanding 23,804 and 23,178 shares, respectively, with no stated value		
Additional paid-in capital	150,078	147,440
Common Shares held in treasury, 186 and 54 shares, respectively, at cost	(151)	(65)
Retained earnings	21,701	7,188
Accumulated other comprehensive income (loss)	6,994	(572)
Total shareholders equity	178,622	153,991
Total Liabilities and Shareholders Equity	$ 501,807	$ 463,038

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	For the Fiscal Years Ended December 31,		
	2006	**2005**	**2004**
Net Sales	$ 708,699	$ 671,584	$ 681,795
Costs and Expenses:			
Cost of goods sold	549,793	522,996	506,808
Selling, general and administrative	124,302	116,836	114,480
Provision for doubtful accounts	236	3,711	354
(Gain) loss on sale of property, plant and equipment, net	(1,303)	(360)	186
Goodwill impairment charge			183,450
Restructuring charges	608	5,098	2,087
Operating Income (Loss)	35,063	23,303	(125,570)
Interest expense, net	21,744	23,872	24,456
Equity in earnings of investees	(7,125)	(4,052)	(1,698)
Other (income) loss, net	805	(953)	828
Income (Loss) Before Income Taxes	19,639	4,436	(149,156)
Provision (benefit) for income taxes	5,126	3,503	(56,653)
Net Income (Loss)	$ 14,513	$ 933	$ (92,503)
Basic net income (loss) per share	$ 0.63	$ 0.04	$ (4.09)
Basic weighted average shares outstanding	22,866	22,709	22,622
Diluted net income (loss) per share	$ 0.63	$ 0.04	$ (4.09)
Diluted weighted average shares outstanding	23,062	22,775	22,622

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Fiscal Years Ended December 31,		
	2006	**2005**	**2004**
OPERATING ACTIVITIES:			
Net income (loss)	$ 14,513	$ 933	$ (92,503)
Adjustments to reconcile net income to net cash provided (used) by operating activities -			
Depreciation	25,904	25,861	25,137
Amortization	1,657	1,560	1,620
Deferred income taxes	3,466	815	(57,563)
Earnings of equity method investees, less dividends received	(3,455)	(1,894)	(1,639)
(Gain) loss on sale of fixed assets	(1,303)	(360)	186
Gain on sale of partnership interest	(1,627)		
Share-based compensation expense	1,953	1,695	1,389
Postretirement benefit settlement gain	(1,242)		
Goodwill impairment charge			183,450
Changes in operating assets and liabilities -			
Accounts receivable, net	(2,739)	(3,516)	(9,511)
Inventories, net	(2,350)	517	(6,981)
Prepaid expenses and other	1,742	(3,744)	(440)
Other assets	2,228	(1,762)	505
Accounts payable	14,084	505	2,596
Accrued expenses and other	(6,291)	(1,549)	2,030
Net cash provided by operating activities	46,540	19,061	48,276
INVESTING ACTIVITIES:			
Capital expenditures	(25,895)	(28,934)	(23,917)
Proceeds from sale of fixed assets	2,266	1,664	1
Proceeds from sale of partnership interest	1,153		
Business acquisitions and other	(2,133)	(282)	(702)
Collection of loan receivable from joint venture			4,695
Net cash used by investing activities	(24,609)	(27,552)	(19,923)
FINANCING ACTIVITIES:			
Repayments of long-term debt	(44)	(118)	(524)
Share-based compensation activity	301	1	(380)
Other financing costs	(150)	(241)	(134)
Net cash provided (used) by financing activities	107	(358)	(1,038)

Effect of exchange rate changes on cash and cash equivalents	3,060	(2,699)	875
Net change in cash and cash equivalents	25,098	(11,548)	28,190
Cash and cash equivalents at beginning of period	40,784	52,332	24,142
Cash and cash equivalents at end of period	$ 65,882	$ 40,784	$ 52,332
Supplemental disclosure of cash flow information:			
Cash paid for interest, net	$ 20,565	$ 22,683	$ 23,321
Cash paid for income taxes, net	$ 2,394	$ 4,891	$ 4,536

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
(in thousands)

	Number of Common Shares	Number of Treasury Shares	Additional Paid-in Capital	Common Shares Held in Treasury	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity	Comprehensive Income (Loss)
BALANCE, DECEMBER 31, 2003	22,459		$ 143,535		$ 98,758	$ 1,113	$ 243,406	
Net loss					(92,503)		(92,503)	$ (92,503)
Exercise of share options	221		840				840	
Issuance of restricted Common Shares	108							
Forfeited restricted Common Shares	(8)	8						
Share-based compensation matters			1,389				1,389	
Other comprehensive income (loss):								
Minimum pension liability adjustments						(2,224)	(2,224)	(2,224)
Unrealized gain on marketable securities						12	12	12
Currency translation adjustments						4,685	4,685	4,685
Comprehensive loss								$ (90,030)
BALANCE, DECEMBER 31, 2004	22,780	8	145,764		6,255	3,586	155,605	
Net income					933		933	933
	10		48				48	

Exercise of share options								
Issuance of restricted Common Shares	434							
Forfeited restricted Common Shares	(39)	39						
Repurchased Common Shares for treasury	(7)	7		(65)			(65)	
Share-based compensation matters			1,628				1,628	
Other comprehensive income (loss):								
Minimum pension liability adjustments						396	396	396
Unrealized gain on marketable securities						89	89	89
Currency translation adjustments						(4,643)	(4,643)	(4,643)
Comprehensive loss								$ (3,225)
BALANCE, DECEMBER 31, 2005	23,178	54	147,440	(65)	7,188	(572)	153,991	
Net income					14,513		14,513	14,513
Exercise of share options	64		393				393	
Issuance of restricted Common Shares	694							
Forfeited restricted Common Shares	(118)	118						
Repurchased Common Shares for treasury	(14)	14		(86)			(86)	
Share-based compensation matters			2,245				2,245	

Other comprehensive income (loss):								
Minimum pension liability adjustments						1,625	1,625	1,625
Cumulative effect of adopting SFAS No. 158								
Unrealized loss on marketable securities						(84)	(84)	(84)
Currency translation adjustments						6,025	6,025	6,025
Comprehensive income								$ 22,079
BALANCE, DECEMBER 31, 2006	23,804	186	$ 150,078	$ (151)	$ 21,701	$ 6,994	$ 178,622	

The accompanying notes are an integral part of these consolidated financial statements.

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

1. Organization and Nature of Business

Stoneridge, Inc. and its subsidiaries are independent designers and manufacturers of highly engineered electrical and electronic components, modules and systems for the automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle markets.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Stoneridge, Inc. and its wholly-owned and majority-owned subsidiaries (collectively, the Company). Intercompany transactions and balances have been eliminated in consolidation. Joint ventures in which the Company does not have control, but does have the ability to exercise influence over operating and principal policies are accounted for under the equity method (Note 3).

Beginning in 2005, we changed from a calendar year-end to a 52-53 week fiscal year-end. Since then, our fiscal quarters were comprised of 13-week periods. On October 30, 2006, we changed back to a calendar (December 31) fiscal year end, and therefore the 2006 fiscal year ended on December 31, 2006. Our fiscal quarters are now comprised of three month periods.

Cash and Cash Equivalents

The Company considers all short-term investments with original maturities of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value, due to the highly liquid nature and short-term duration of the underlying securities.

Accounts Receivable and Concentration of Credit Risk

Revenues are principally generated from the automotive, medium- and heavy-duty truck, agricultural and off-highway vehicle markets. Due to the nature of these industries, a significant portion of sales and related accounts receivable are concentrated in a relatively small number of customers. The following table presents the Company s principal customers, as a percentage of net sales:

	For the Fiscal Years Ended December 31,		
	2006	**2005**	**2004**
Navistar International	25%	22%	21%
DaimlerChrysler	10	12	11
Ford Motor Company	6	7	7
MAN AG	6	2	2
Deere & Company	6	6	6
General Motors	5	5	7
Other	42	46	46
Total	100%	100%	100%

Accounts receivable from the Company s five largest customer balances aggregated to approximately $57,376, $50,507 and $65,319 at December 31, 2006, 2005 and 2004, respectively.

Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method for approximately 67% and 72% of the Company s inventories at December 31, 2006 and 2005, respectively, and by the first-in, first-

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

out (FIFO) method for all other inventories. Inventory cost includes material, labor and overhead. Inventories consist of the following at December 31:

	2006	2005
Raw materials	$ 39,832	$ 34,026
Work in progress	8,196	8,644
Finished goods	12,614	12,400
Total inventories	60,642	55,070
Less: LIFO reserve	(2,121)	(1,279)
Inventories, net	$ 58,521	$ 53,791

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and consist of the following at December 31:

	2006	2005
Land and land improvements	$ 4,654	$ 5,370
Buildings and improvements	44,526	43,954
Machinery and equipment	130,323	113,377
Office furniture and fixtures	36,103	30,799
Tooling	80,579	72,523
Vehicles	470	486
Leasehold improvements	2,190	1,763
Construction in progress	18,835	17,827
Total property, plant and equipment	317,680	286,099
Less: Accumulated depreciation	(203,094)	(172,621)
Property, plant and equipment, net	$ 114,586	$ 113,478

Depreciation is provided by both the straight-line and accelerated methods over the estimated useful lives of the assets. Depreciation expense for the fiscal years ended December 31, 2006, 2005 and 2004 was $25,904, $25,861 and $25,137, respectively. Depreciable lives within each property classification are as follows:

Buildings and improvements	10 40 years
Machinery and equipment	5 20 years
Office furniture and fixtures	3 10 years
Tooling	2 5 years
Vehicles	3 5 years
Leasehold improvements	3 8 years

Maintenance and repair expenditures that are not considered improvements and do not extend the useful life of property are charged to expense as incurred. Expenditures for improvements and major renewals are capitalized. When assets are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss on the disposition is credited or charged to income.

Goodwill and Other Intangible Assets

Under Statement of Financial Accounting Standard (SFAS) No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*, goodwill is subject to an annual assessment for impairment (or more frequently if impairment indicators arise) by applying a fair value-based test. SFAS 142 requires goodwill impairment testing to be evaluated at the reporting unit level. The Company s operations were reviewed to determine whether such operations should be aggregated into reporting units for testing of goodwill impairment. These operations were reviewed for similar economic characteristics to determine if aggregation was

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

appropriate. The Company determined that a significant number of qualitative similarities existed to allow for aggregation of these operations into four reporting units and two of these reporting units have goodwill that was tested in accordance with the provisions of SFAS 142.

The Company performs its annual impairment test of goodwill as of the beginning of the fourth quarter. The Company uses a combination of valuation techniques, which include consideration of market-based approaches and an income approach, in determining the fair value of the Company s applicable reporting units in the annual impairment test of goodwill. The Company believes that the combination of the valuation models provides a more appropriate valuation of the Company s reporting units by taking into account different marketplace participant assumptions. The Company utilizes market and income approaches, specifically the guideline company method (market), the transaction method (market), and the discounted cash flow method (income), in its estimates of fair value of the Company s reporting units being tested and an equal weight is given to each of these three methods. In addition, all three methods utilize market data in the derivation of a value estimate and are forward-looking in nature. The guideline assessment of future performance and the discounted cash flow method utilize a market-derived rate of return to discount anticipated performance.

These methodologies are applied to the reporting units adjusted historical and projected financial performance. The impairment review is highly judgmental and involves the use of significant estimates and assumptions. These estimates and assumptions have a significant impact on the amount of any impairment charge recorded. Discounted cash flow methods are dependent upon assumption of future sales trends, market conditions and cash flows of each reporting unit over several years. Actual cash flows in the future may differ significantly from those previously forecasted. Other significant assumptions include growth rates and the discount rate applicable to future cash flows.

As of the beginning of the fourth quarter, the goodwill balance of $65.2 million was related entirely to the Control Devices reportable segment. The Company completed its assessment of any potential goodwill impairment as of October 1, 2006 and October 2, 2005 and determined that no impairment existed as of either date. As of October 1, 2004, the Company determined that the carrying value of goodwill of one of the Company s reporting units, which is included in the Control Devices reportable segment, exceeded its fair value by $183.5 million. The corresponding write-down of goodwill to its fair value was reported as a component of operating loss in the Company s consolidated statement of operations for the fourth quarter of 2004.

The Company had the following finite-lived intangible assets included as a component of other assets in the balance sheet at December 31:

	2006	2005
Patents:		
Gross carrying amount	$ 2,779	$ 2,779
Less: Accumulated amortization	(2,372)	(2,102)
Net carrying amount	$ 407	$ 677

Aggregate amortization expense on patents was $270 and $301 for the fiscal years ended December 31, 2006 and December 31, 2005, respectively. Estimated amortization expense for each succeeding fiscal year based upon the Company s intangible asset portfolio at December 31, 2006 is as follows:

	Estimated Amortization Expense
2007	$ 204
2008	203

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following at December 31:

	2006	2005
Compensation-related obligations	$ 15,128	$ 13,712
Insurance-related obligations	4,178	5,281
Income tax-related obligations	3,755	3,576
Warranty- and recall-related obligations	5,825	6,220
Other	16,738	17,814
Total accrued expenses and other current liabilities	$ 45,624	$ 46,603

Income Taxes

The Company accounts for income taxes using the provisions of SFAS No. 109, *Accounting for Income Taxes*. Deferred income taxes reflect the tax consequences on future years of differences between the tax basis of assets and liabilities and their financial reporting amounts. Future tax benefits are recognized to the extent that realization of such benefits is more likely than not to occur.

Currency Translation

The financial statements of foreign subsidiaries, where the local currency is the functional currency, are translated into U.S. dollars using exchange rates in effect at the period end for assets and liabilities and average exchange rates during each reporting period for the results of operations. Adjustments resulting from translation of financial statements are reflected as a component of accumulated other comprehensive income (loss). Foreign currency transactions are remeasured into the functional currency using translation rates in effect at the time of the transaction, with the resulting adjustments included in the results of operations.

Revenue Recognition and Sales Commitments

The Company recognizes revenues from the sale of products, net of actual and estimated returns, at the point of passage of title, which is generally at the time of shipment. Actual and estimated returns are based on authorized returns and historical trends of sales returns. The Company often enters into agreements with its customers at the beginning of a given vehicle s expected production life. Once such agreements are entered into, it is the Company s obligation to fulfill the customers purchasing requirements for the entire production life of the vehicle. These agreements are subject to renegotiation, which may affect product pricing.

Allowance for Doubtful Accounts

The Company evaluates the collectibility of accounts receivable based on a combination of factors. In circumstances where the Company is aware of a specific customer s inability to meet its financial obligations, a specific allowance for doubtful accounts is recorded against amounts due to reduce the net recognized receivable to the amount the Company reasonably believes will be collected. Additionally, the Company reviews historical trends for collectibility in determining an estimate for its allowance for doubtful accounts. If economic circumstances change substantially, estimates of the recoverability of amounts due to the Company could be reduced by a material amount. The Company does not have collateral requirements with its customers.

Product Warranty and Recall Reserves

Amounts accrued for product warranty and recall claims are established based on the Company s best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet dates. These accruals are based on several factors including past experience, production changes, industry developments and various other considerations. The Company can provide no assurances that it will not experience material claims in the future or that it will not incur significant costs to defend or settle such claims beyond the amounts accrued or beyond what the Company may recover from its suppliers.

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

The following provides a reconciliation of changes in product warranty and recall liability for the fiscal years ended December 31, 2006 and 2005:

	2006	2005
Product warranty and recall at beginning of period	$ 6,220	$ 6,644
Accruals for products shipped during period	3,695	3,401
Changes in estimates for existing liabilities	31	490
Settlements made during the period (in cash or in kind)	(4,121)	(4,315)
Product warranty and recall at end of period	$ 5,825	$ 6,220

Product Development Expenses

Expenses associated with the development of new products and changes to existing products are charged to expense as incurred. These costs amounted to $40,840, $39,193 and $36,145 in fiscal years 2006, 2005 and 2004, respectively.

Share-Based Compensation

At December 31, 2006, the Company had three types of share-based compensation plans: (1) Long-Term Incentive Plan (the Incentive Plan), (2) Directors Share Option Plan (the Director Option Plan) and (3) the Directors Restricted Shares Plan. One plan is for employees and two plans are for non-employee directors. The Incentive Plan is made up of the Long-Term Incentive Plan that was approved by the Company s shareholders on September 30, 1997 (the 1997 Plan) and expires on June 30, 2007 and the Amended and Restated Long-Term Incentive Plan (the 2006 Plan) that was approved by the Company s shareholders on April 24, 2006 and expires on April 24, 2016. Prior to the second quarter of 2005, the Company accounted for its plans under the fair value recognition provisions of SFAS No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*, adopted prospectively for all employee and director awards granted, modified or settled after January 1, 2003, under the provisions of SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS 123*.

Effective at the beginning of the second quarter of 2005, the Company adopted SFAS No. 123(R) (SFAS 123(R)), *Share-Based Payment*, using the modified-prospective-transition method. Because the Company had previously adopted the fair value recognition provisions required by SFAS 123, and due to the fact that all unvested awards at the time of adoption were being recognized under a fair value approach, the adoption of SFAS 123(R) did not significantly impact the Company s operating income, income before income taxes, net income, cash flow from operating activities, cash flow from financing activities, or basic and diluted net income per share for the fiscal years ended December 31, 2006 and 2005.

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

The following table illustrates the effect on net income (loss) and net income (loss) per share if the fair value method had been applied to all outstanding and unvested awards in each period.

	For the Fiscal Years Ended December 31,	
	2005	2004
Net income (loss), as reported	$ 933	$ (92,503)
Add: Share-based compensation expense included in reported net income (loss), net of related tax effects	1,102	868
Deduct: Total share-based compensation expense determined under the fair value method for all awards, net of related tax effects	(1,103)	(906)
Pro forma net income (loss)	$ 932	$ (92,541)
Net income (loss) per share:		
Basic as reported	$ 0.04	$ (4.09)
Basic pro forma	$ 0.04	$ (4.09)
Diluted as reported	$ 0.04	$ (4.09)
Diluted pro forma	$ 0.04	$ (4.09)

Total compensation expense recognized in the consolidated statements of operations for share-based compensation arrangements was $1,953, $1,695 and $1,389 for the fiscal years ended December 31, 2006, 2005 and 2004, respectively. The total income tax benefit recognized in the consolidated statements of operations for share-based compensation arrangements was $355, $593 and $521 for the fiscal years ended December 31, 2006, 2005 and 2004, respectively. There was no share-based compensation expense capitalized as inventory or fixed assets for 2006, 2005 or 2004.

The fair value of options granted under the Incentive Plan and Director Option Plan was estimated at the date of grant using the Black-Scholes option-pricing model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of options granted was the period of time that the option was expected to remain outstanding. Expected volatility was based on historical volatility of the Company s Common Shares. The following are assumptions that were used to estimate the fair value of the options granted in 2004:

	2004
Risk-free interest rate	1.43%
Expected dividend yield	0.00%
Expected life (in years)	1.0
Expected volatility	35.18%

Financial Instruments and Derivative Financial Instruments

Financial instruments, including derivative financial instruments, held by the Company include cash and cash equivalents, accounts receivable, accounts payable, long-term debt and foreign currency forward and option contracts. The carrying value of cash and cash equivalents, accounts receivable and accounts payable is considered to be representative of fair value because of the short maturity of these instruments. The carrying value of the Company s variable rate debt approximates its fair value. Refer to Note 9 of the Company s consolidated financial statements for fair value disclosures of the Company s fixed rate debt, foreign currency forward and option contracts, and currency swap contracts.

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

Common Shares Held in Treasury

The Company accounts for Common Shares held in treasury under the cost method and includes such shares as a reduction of total shareholders equity.

Accounting Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including certain self-insured risks and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Because actual results could differ from those estimates, the Company revises its estimates and assumptions as new information becomes available.

Net Income (Loss) Per Share

Net income (loss) per share amounts for all periods are presented in accordance with SFAS No. 128 (SFAS 128), *Earnings Per Share*, which requires the presentation of basic and diluted net income per share. Basic net income (loss) per share was computed by dividing net income (loss) by the weighted-average number of Common Shares outstanding for each respective period. Diluted net income (loss) per share was calculated by dividing net income (loss) by the weighted-average of all potentially dilutive Common Shares that were outstanding during the periods presented. Actual weighted-average shares outstanding used in calculating basic and diluted net income (loss) per share were as follows:

	For the Fiscal Years Ended December 31,		
	2006	**2005**	**2004**
Basic weighted-average shares outstanding	22,866,015	22,709,113	22,622,188
Effect of dilutive securities	195,870	65,861	
Diluted weighted-average shares outstanding	23,061,885	22,774,974	22,622,188

Diluted net loss per share for the fiscal year ended December 31, 2004, as reported in the Company s consolidated statements of operations in accordance with SFAS 128, disregards the effect of potentially dilutive Common Shares, as a net loss causes dilutive shares to have an anti-dilutive effect.

Options not included in the computation of diluted net income (loss) per share to purchase 599,850, 474,250 and 225,000 Common Shares at an average price of $12.17, $13.93 and $16.56 per share were outstanding at December 31, 2006, 2005 and 2004, respectively. These outstanding options were not included in the computation of diluted net income (loss) per share because their respective exercise prices were greater than the average market price of Common Shares and, therefore, their effect would have been anti-dilutive.

As of December 31, 2006, 396,825 performance-based restricted shares were outstanding. These shares were not included in the computation of diluted net income (loss) per share because not all vesting conditions were met as of the December 31, 2006. Approximately one third of these shares was associated with a plan that used highly optimistic earnings per share targets. At this time, we believe that meeting such thresholds is highly unlikely. The remainder may or may not become dilutive based on the Company s ability to meet or exceed future earnings thresholds.

Comprehensive Income (Loss)

SFAS No. 130, *Reporting Comprehensive Income*, establishes standards for the reporting and display of comprehensive income. Other comprehensive income includes foreign currency translation adjustments and gains and losses from certain foreign currency transactions, the effective portion of gains and losses on certain hedging activities, minimum pension liability adjustments, and unrealized gains and losses on available-for-sale marketable securities.

Table of Contents

STONERIDGE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share data, unless otherwise indicated)

The components of accumulated other comprehensive income (loss), as reported in the statement of consolidated shareholders equity as of December 31, net of tax were as follows:

	Currency Translation Adjustments	Pension Liability Adjustments	Unrealized Loss (Gain) on Marketable Securities	Accumulated Other Comprehensive Income (Loss)
Balance, January 1, 2004	$ 2,458	$ (1,264)	$ (81)	$ 1,113
Current year change	4,685	(2,224)	12	2,473
Balance, December 31, 2004	7,143	(3,488)	(69)	3,586
Current year change	(4,643)	396	89	(4,158)
Balance, December 31, 2005	2,500	(3,092)	20	(572)
Current year change	6,025	1,625	(84)	7,566
Balance, December 31, 2006	$ 8,525	$ (1,467)	$ (64)	$ 6,994

The tax effects related to each component of other comprehensive income (loss) were as follows:

	Before Tax Amount	Benefit / (Provision)	After-Tax Amount
2004			
Foreign currency translation adjustments	$ 4,685	$	$ 4,685
Pension liability adjustments	(3,177)	953	(2,224)
Unrealized loss on marketable securities	18	(6)	12
Other comprehensive income	$ 1,526	$ 947	$ 2,473
2005			
Foreign currency translation adjustments	$ (4,643)	$	$ (4,643)
Pension liability adjustments	566	(170)	396
Unrealized loss on marketable securities	137	(48)	89
Other comprehensive loss	$ (3,940)	$ (218)	$ (4,158)
2006			