ZIX CORP
Form 10-Q
May 10, 2006

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

(Mark One)

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

For the quarterly period ended March 31, 2006

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: 0-17995

ZIX CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Texas	**75-2216818**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

2711 North Haskell Avenue
Suite 2200, LB 36
Dallas, Texas 75204-2960
(Address of Principal Executive Offices)
(214) 370-2000
(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No 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 Exchange Act). Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at May 1, 2006**
Common Stock, par value $.01 per share	**59,638,839**

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PART FINANCIAL INFORMATION

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ZIX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,158,000	$ 20,240,000
Restricted cash	5,102,000	5,100,000
Receivables, net	413,000	149,000
Prepaid and other current assets	1,654,000	1,845,000
Total current assets	21,327,000	27,334,000
Restricted cash	35,000	35,000
Property and equipment, net	3,377,000	3,652,000
Intangible assets, net	379,000	559,000
Goodwill	2,161,000	2,161,000
Deferred financing costs and other assets	325,000	374,000
	$ 27,604,000	$ 34,115,000
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,042,000	$ 1,313,000
Accrued expenses	3,505,000	3,749,000
Deferred revenue	7,824,000	7,087,000
Customer deposit	2,020,000	1,000,000
Capital lease obligations	103,000	165,000
Promissory note payable	2,330,000	
Short-term note payable	192,000	268,000
Convertible promissory note payable	4,504,000	4,404,000
Total current liabilities	21,520,000	17,986,000
Long-term liabilities:		
Deferred revenue	1,325,000	1,261,000
Customer deposit		2,000,000
Promissory note payable		2,226,000
Deferred rent	239,000	245,000
Total long-term liabilities	1,564,000	5,732,000
	23,084,000	23,718,000
Contingencies (Note 14)		
Stockholders equity:		
Preferred stock, $1 par value, 10,000,000 shares authorized; none issued and outstanding		
	520,000	519,000

Common stock, $0.01 par value, 175,000,000 shares authorized; 52,027,281 issued and 49,700,100 outstanding in 2006 and 51,932,561 issued and 49,605,380 outstanding in 2005		
Additional paid-in capital	309,457,000	308,461,000
Treasury stock, at cost; 2,327,181 common shares in 2006 and 2005	(11,507,000)	(11,507,000)
Accumulated deficit	(293,950,000)	(287,076,000)
Total stockholders equity	4,520,000	10,397,000
	$ 27,604,000	$ 34,115,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2006	2005
Revenues:		
Services	$ 3,895,000	$ 3,298,000
Hardware		185,000
Software		100,000
Total revenues	3,895,000	3,583,000
Cost of revenues	3,375,000	3,891,000
Gross margin (loss)	520,000	(308,000)
Operating expenses:		
Research and development expenses	1,595,000	1,975,000
Selling, general and administrative expenses	6,592,000	7,502,000
Customer deposit forfeiture	(1,000,000)	
Gain of sale of product lines		(950,000)
Total operating expenses	7,187,000	8,527,000
Operating loss	(6,667,000)	(8,835,000)
Other (expense) income:		
Investment and other income	217,000	143,000
Interest expense	(418,000)	(830,000)
Total other (expense) income	(201,000)	(687,000)
Loss before income taxes	(6,868,000)	(9,522,000)
Income taxes	(6,000)	(50,000)
Net loss	$ (6,874,000)	$ (9,572,000)
Basic and diluted loss per common share	$ (0.14)	$ (0.30)
Basic and diluted weighted average common shares outstanding	49,654,338	32,295,162

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(Unaudited)

	Stockholders Equity					
	Common Stock		Additional Paid-In	Treasury	Accumulated	Total Stockholders
	Shares	Amount	Capital	Stock	Deficit	Equity
Balance, January 1, 2006	51,932,561	$ 519,000	$ 308,461,000	$ (11,507,000)	$ (287,076,000)	$ 10,397,000
Common stock issued to employees for compensation in lieu of cash	82,196	1,000	156,000			157,000
Common stock issued in lieu of cash for third-party services	12,524		20,000			20,000
Employee share-based compensation costs			767,000			767,000
Value of additional warrants issued			50,000			50,000
Non-employee stock-based compensation			3,000			3,000
Net loss					(6,874,000)	(6,874,000)
Balance, March 31, 2006	52,027,281	$ 520,000	$ 309,457,000	$ (11,507,000)	$ (293,950,000)	$ 4,520,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31, 2006	2005
Operating activities:		
Net loss	$ (6,874,000)	$ (9,572,000)
Non-cash items in net loss:		
Depreciation and amortization	779,000	1,135,000
Amortization of debt discount / premium, financing costs and other	307,000	552,000
Value of additional warrants issued	10,000	
Amortization of discount on notes receivable		(5,000)
Common stock issued to employees and non-employee in lieu of cash	177,000	243,000
Employee share-based compensation costs	767,000	
Non-employee share-based compensation	3,000	56,000
Customer deposit forfeiture	(1,000,000)	
Gain on sale of product lines		(950,000)
Changes in operating assets and liabilities, excluding effects of acquisitions:		
Accounts receivable	(264,000)	28,000
Other assets	175,000	314,000
Accounts payable	(197,000)	677,000
Deferred revenue	801,000	460,000
Customer deposits	20,000	
Accrued and other liabilities	(250,000)	(324,000)
Net cash used by operating activities	(5,546,000)	(7,386,000)
Investing activities:		
Purchases of property and equipment	(398,000)	(685,000)
Sales and maturities of marketable securities		12,997,000
Purchase of restricted cash investment		(36,000)
Proceeds from sale of product line		1,840,000
Net cash (used) provided by investing activities	(398,000)	14,116,000
Financing activities:		
Proceeds from exercise of stock options		3,000
Payment of short-term notes payable, capital leases and other	(138,000)	(109,000)
Net cash used by financing activities	(138,000)	(106,000)
(Decrease) increase in cash and cash equivalents	(6,082,000)	6,624,000
Cash and cash equivalents, beginning of period	20,240,000	3,856,000
Cash and cash equivalents, end of period	$ 14,158,000	$ 10,480,000

See notes to condensed consolidated financial statements.

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ZIX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements of Zix Corporation (ZixCorp or the Company) should be read in conjunction with the audited consolidated financial statements included in the Company s 2005 Annual Report to Shareholders on Form 10-K. These financial statements are unaudited, but have been prepared in the ordinary course of business for the purpose of providing information with respect to the interim periods. Management of the Company believes that all adjustments necessary for a fair presentation for such periods have been included and are of a normal recurring nature. The results of operations for the three-month period ended March 31, 2006, are not necessarily indicative of the results to be expected for the full year.

2. Company Overview and Liquidity

As of January 1, 2006, the Company operates two reporting segments, Email Encryption and e-Prescribing, which provide services that protect, manage and deliver sensitive electronic information. Email Encryption is a comprehensive suite of secure messaging services which enable an enterprise to use policy-driven rules to determine which emails need to be sent securely in order to comply with regulations or corporate policy. In 2005, Email Encryption was combined with the Message Inspector and Web Inspector products (MI/WI) and referred to as the eSecure product line. MI/WI was acquired in the Elron Software, Inc. acquisition in September 2003 and subsequently sold to CyberGuard Corporation (CyberGuard) in March 2005 (see Note 7). Email Encryption is commonly referred to as Secure Messaging. e-Prescribing consists of a single product line called PocketScript®. PocketScript is an electronic prescribing service that enables physicians to use a handheld device to prescribe drugs and transmit the prescription electronically to any pharmacy. During the prescribing process, the physician is provided with real-time information such as insurance formulary and drug interactions that normally would not be available in a paper prescription format. This allows the physician to leverage technology for better patient care at the point of delivery. In 2005, e-Prescribing was combined with the Dr. Chart product and referred to as the eHealth product line. Dr. Chart was acquired in the MyDocOnline acquisition in January 2004 and subsequently sold to MITEM Corporation (MITEM) in September 2005 (see Note 7).

Prior to January 1, 2006 the Company was operated and managed as a single reporting segment.

Company History

In 1999, the Company began developing and marketing products and services that bring privacy, security and convenience to Internet users. ZixMail, a desktop solution for encrypting and securely delivering email, was first commercially introduced in the first quarter of 2001. In 2002, the Company began offering additional email encryption products such as:

- ZixVPM® (Virtual Private Messenger): an e-messaging gateway service that provides company-wide privacy protection for inbound and outbound email communications.
- ZixAuditor®: an assessment service used to analyze email traffic patterns and monitor compliance with corporate and regulatory policies.
- ZixPort®: a secure Web-messaging portal.

In July 2003, the Company acquired substantially all of the operating assets and the business of PocketScript, LLC (PocketScript), a privately held development stage enterprise that provided electronic prescription services for the healthcare industry. This acquisition enabled the Company to expand its services into care delivery solutions, specifically, the e-Prescribing marketplace. PocketScript is the cornerstone offering in the current e-Prescribing product line.

In 2004, the Company made a strategic decision to focus the Company s resources and efforts towards the two core products of Secure Messaging and PocketScript. Subsequently, on November 4, 2004, the Company announced that it was terminating the Connect service for online doctor visits, which is one of the products acquired in the MyDocOnline acquisition in January 2004. On March 11, 2005, the MI/WI product lines, which were acquired in the

Elron acquisition, were sold to CyberGuard (see Note 7). On September 30, 2005, the Company sold the remaining MyDocOnline product (Dr. Chart) to MITEM (see Note 7).

The Company s Email Encryption and e-Prescribing services are primarily offered as a hosted-service solution, whereby customers pay for annual service subscription contracts at the inception of the service period. A significant up-front investment is

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required to establish the service and secure enough subscribers to make the business successful. Additionally, the Company offers some services through transaction or usage-based fees.

Due to the Company s history of operating with spending in excess of customer receipts, liquidity is of special importance. Essential to liquidity is the ability of the Company to achieve and retain subscriber bases in both core product offerings to overcome the costs of offering the service and become cash flow positive, ideally from operations, but augmented as required by financing or investing activities.

Based on the Company s organization and current order rates as of March 31, 2006, the annualized operating spending for the next twelve months is projected to be between $40,000,000 and $42,000,000. Using flat year-on-year order rates for Email Encryption, consistent renewal rates for subscribers, and an expectation of cash flow only from payors with whom the Company has a current relationship, cash receipt projections for the next twelve months are $24,000,000 to $26,000,000. These cash receipt projections, when combined with $14,158,000 unrestricted cash on hand at March 31, 2006, and $10,900,000 net proceeds from the private placement in April 2006, as described in Note 15, provides for an estimated $49,058,000 to $51,058,000 in cash available to fund the expected spending of $40,000,000 to $42,000,000 for the next twelve months.

The Company believes it has adequate resources and liquidity to sustain operations for at least the next twelve months and is targeting cash flow improvements to augment its liquidity beyond that time, taking into account the following factors: relatively low contractual spending commitments over the next twelve months, historically high renewal rates for Email Encryption, continued growth in the Email Encryption business, increased mix of cash receipts attributable to the more profitable out years of contracts, the discretionary nature of the cash spend in excess of cash receipts in the emerging area of e-Prescribing and general flexibility of spending in other areas.

As contractual cash collections and expected increases in cash sources are not always certain, the Company has the ability to adjust cash spending to react to any shortfalls in actual cash collections or to adjust spending in certain investment areas should cash receipts make that possible or, if warranted and if the terms are acceptable, with additional external financing, receipts from exercised stock options and warrants of the Company s common stock or strategic partnerships. However, operating in emerging and developing markets involves risk and uncertainties, and there are no assurances that the Company will ultimately achieve or achieve in a sufficiently timely manner its targeted improvements. Beyond the next twelve months and should business results not have improved sufficiently as projected, the Company could have to alter its business plan or further augment its cash flow position through cost reduction measures, sales of assets, additional financings or a combination of these actions. Operationally, the extent and timing of success, or lack thereof, in the e-Prescribing market and continue improvement in Email Encryption will ultimately be the most significant operational determinants of liquidity.

3. Revenue and Significant Customers

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States of America, as promulgated by SOP 97-2, *Software Revenue Recognition,* SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With respect to Certain Transactions,* Emerging Issues Task Force (EITF) Abstract No. 00-21, *Revenue Arrangements with Multiple Deliverables,* and Securities and Exchange Commission Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements,* and other related pronouncements.

The Company develops, markets, licenses and supports electronic information protection services and related software products. The Company s services can be placed into several key revenue categories where each category has similar revenue recognition traits; Email Encryption subscription-based services, e-Prescribing service, various transaction fees and related professional services. A majority of the revenues generated by the Company are through direct sales; however, the Company employs a network of distributors and resellers. Under all product categories and distribution models, the Company recognizes revenue after all of the following occur: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable, and collectability is reasonably assured. In the event the arrangement has multiple elements with delivered and undelivered elements, revenue for the delivered elements are recognized under the residual method only when vendor-specific objective evidence of fair value (VSOE) exists to allocate the fair value of the total fees to the undelivered elements of the arrangement. Occasionally, when ZixCorp is engaged in a complex product deployment, customer acceptance may have to occur before the transaction is considered complete. In this situation no revenue is recognized until the customer accepts the product. Discounts provided to customers are recorded as reductions in revenue.

The Email Encryption services of ZixMail, ZixVPM, ZixPort, and ZixAuditor are subscription-based services. In the first quarter of 2005, subscription-based services also included Dr. Chart. Providing these services includes delivering licensed software and providing secure electronic communications and customer support throughout the subscription period. In the case of ZixVPM, typically, as part of the service, an appliance with pre-installed software is installed at the customer site at the beginning of the subscription period. In a subscription service, the customer does not own a perpetual right to a software license, but is instead granted the use of that license during the period of the service subscription. Subscriptions are generally multiple-year contracts that are irrevocable and non-refundable in nature and require annual, up-front payments. The subscription period begins on the date specified by the parties or when the service is fully functional for the customer which is consequently deemed to be the date of acceptance. Revenues from subscription services are recorded as service revenue as the services are rendered from the date of acceptance over the subscription period. Subscription fees received from customers in advance are recorded as deferred revenue and recognized as revenues ratably over the subscription period.

On September 30, 2005, the Dr. Chart product line was sold to MITEM. This product line was acquired in January 2004 through the acquisition of MyDocOnline, Inc. For the three-month period ended March 31, 2005, Dr. Chart product line contributed $70,000 in revenue (see Note 7).

e-Prescribing service arrangements contain multiple deliverables including both hardware and services. Due to the lack of VSOE, these elements are combined into a single unit of accounting and, similar to Email Encryption, recognized as service revenue ratably over the longer of the subscription term or expected renewal period. Revenue recognition begins upon installation of the required hardware and commencement of service. Prior to the third quarter 2005, the Company did maintain VSOE for certain service elements of the e-Prescribing service. Accordingly, the residual value assigned to the PocketScript handheld device was recognized as revenue upon installation. The fair value of the undelivered services are being recognized ratably over period in which those services are delivered.

In the first quarter 2005, the Company sold anti-spam filtering, email content filtering, and Web filtering solutions under the MI/WI product lines to customers under perpetual licensing arrangements. These perpetual software licenses were normally sold as part of multiple-element arrangements that included annual maintenance and/or subscription, and may have included implementation or training services. Evidence of VSOE for implementation and training services associated with the anti-spam, email content filtering and Web filtering arrangements was based upon standard billing rates and the estimated level of effort for the individuals expected to perform the related services. Installation and training revenues were recognized as the services were rendered. The Company established VSOE for maintenance based upon maintenance that was sold separately. Maintenance revenue was recognized over the term of the maintenance agreement, generally one year.

On March 11, 2005, the MI/WI product lines were sold to CyberGuard (see Note 7). For the three-month period ended March 31, 2005, MI/WI contributed $637,000 in revenue.

Some of the Company s services incorporate a transaction fee per event occurrence or when predetermined usage levels have been reached. These fees are recognized as revenue when the transaction occurs or when the predetermined usage levels have been achieved, and when the amounts are fixed and determinable.

The Company does not offer standalone professional services. Further, the Company s services include various warranty provisions; however, warranty expense was not material to any period presented.

For the quarter ended March 31, 2006, no customers accounted for more than 10% of total revenues. For the quarter ended March 31, 2005, Blue Cross and Blue Shield of Massachusetts, Inc., an e-Prescribing customer, accounted for approximately 19%, or $674,000 of total revenues. No other single customer accounted for 10% or more of the Company s total revenues for the quarter ended March 31, 2005.

4. Segment Information

As of January 1, 2006, the Company began to manage the business in two reportable segments: Email Encryption and e-Prescribing as discussed in Note 2.

The Company s Chief Executive Officer and Chief Financial Officer have been identified as the chief operating decisions makers (CODM) in assessing the performance of each segment and determining the related allocation of resources.

To determine the allocation of resources the CODM generally assesses the performance of each segment based on revenue, gross margin, and direct expenses which include research and development expenses and selling and marketing expenses that are directly attributable to the segments. Assets and most corporate costs are not allocated to the segments and are not used to determine resource allocation. Any transactions that are considered a one-time occurrence or not likely to be repeated in future periods are excluded from the CODM s assessments. The accounting policies of the reportable segments are the same as those applied to the condensed consolidated financial statements.

Corporate includes charges such as corporate management, compliance and other non-operational activities that cannot be directly attributed to a reporting segment. In addition, corporate also includes the revenues and direct costs of products that have been sold or otherwise discontinued by the Company. In 2005, the Company sold two product lines: MI/WI and Dr. Chart (see Note 7). These products contributed $707,000 of revenue in the quarter ended March 31, 2005.

Prior to January 1, 2006, the Company was operated and managed as a single reporting unit. Amounts shown below for any period prior to January 1, 2006, are estimations prepared for comparative purposes only.

	Three Months Ended March 31, 2006				Three Months Ended March 31, 2005			
	Email Encryption	e-Prescribing	Corporate	Total	Email Encryption	e-Prescribing	Corporate	Total
Revenues	$ 3,333,000	$ 562,000	$	$ 3,895,000	$ 2,044,000	$ 832,000	$ 707,000	$ 3,583,000
Cost of revenues	1,466,000	1,909,000		3,375,000	1,314,000	1,800,000	777,000	3,891,000
Gross margin (loss)	1,867,000	(1,347,000)		520,000	730,000	(968,000)	(70,000)	(308,000)
Direct expenses	2,945,000	2,604,000		5,549,000	3,056,000	2,659,000	711,000	6,426,000
Segment (loss)	(1,078,000)	(3,951,000)		(5,029,000)	(2,326,000)	(3,627,000)	(781,000)	(6,734,000)
Unallocated (expense) / income								
Marketing, general and administrative expense			(2,638,000)	(2,638,000)			(3,051,000)	(3,051,000)
Gain of sales of product line							950,000	950,000
Customer deposit forfeiture			1,000,000	1,000,000				
Investment and other income			217,000	217,000			143,000	143,000
Interest Expense			(418,000)	(418,000)			(830,000)	(830,000)
Total			(1,839,000)	(1,839,000)			(2,788,000)	(2,788,000)
	$ (1,078,000)	$ (3,951,000)	$ (1,839,000)	$ (6,868,000)	$ (2,326,000)	$ (3,627,000)	$ (3,569,000)	$ (9,522,000)

Loss before
income taxes

Revenues from international customers and long-lived assets located outside of the United States are not material to the condensed consolidated financial statements.

As mentioned above, the Company does not allocate resources based on assets; however, for disclosure purposes total assets by segment are shown below. Assets reported under each segment include only those that provide a direct and exclusive benefit to that segment. Assets assigned to each segment include accounts receivable and related allowances, prepaid and other assets, property and equipment and related accumulated depreciation, goodwill, and intangible assets and related accumulated amortization. All other corporate and shared assets are recorded under Corporate .

	March 31, 2006				December 31, 2005			
	Email Encryption	e-Prescribing	Corporate	Total	Email Encryption	e-Prescribing	Corporate	Total
Total assets	$ 3,949,000	$ 1,202,000	$ 22,453,000	$ 27,604,000	$ 3,969,000	$ 1,436,000	$ 28,710,000	$ 34,115,000

5. Stock Options and Stock-based Employee Compensation

Below is a summary of common stock options outstanding at March 31, 2006:

	Authorized Shares	Options Outstanding	Options Vested	Available for Grant
Employee and Director Stock Option Plans:				
1990 Stock Option Plan	345,045	2,500	2,500	
1992 Stock Option Plan	450,000	65,666	65,666	
1995 Long-term Incentive Plan	1,825,000	1,362,100	913,766	
1996 Director s Stock Option Plan	225,000	62,500	62,500	
1999 Director s Stock Option Plan	975,000	826,153	770,625	
2001 Stock Option Plan	2,525,000	1,887,740	787,225	171,350
2001 Employee Stock Option Plan	300,000	223,643	166,516	32,810
2003 New Employee Stock Option Plan	500,000	481,400	324,317	18,600
2004 Stock Option Plan	3,200,000	1,791,860	463,515	1,408,140
2004 Director s Stock Option Plan	300,000	270,832	126,250	29,168
Cook Employee Transferred Options	807,127	18,000	18,000	
Total employee and director stock option plans	11,452,172	6,992,394	3,700,880	1,660,068
Executive Stock Option Agreements:				
John A. Ryan, former Chairman and CEO	1,000,000	1,000,000	1,000,000	
Richard D. Spurr, Chairman, President and CEO	650,000	650,000	472,727	
Other executive stock option agreements	450,000	158,665	158,665	
Total executive stock option agreements	2,100,000	1,808,665	1,631,392	
Other Stock Option Agreements	70,000	70,000	70,000	
Total	13,622,172	8,871,059	5,402,272	1,660,068

Under all of the Company s stock option plans, new shares are issued when options are exercised.

Employee and Director Stock Option Plans

The Company has non-qualified stock options outstanding to employees, directors, and third parties under various stock option plans. The exercise price of options granted under these plans are generally not less than the fair market value at the date of grant and, subject to termination of employment, generally expire ten years from the date of grant. Employee options generally vest in installments over three years. Option grants to employees, officers and directors frequently contain accelerated vesting provisions upon the occurrence of a change of control, as defined in the applicable option agreements. At March 31, 2006, 1,660,068 shares of common stock were available for future grants under the Company s stock option plans.

Cook Employee Transferred Options During 2000 and 2001, David Cook, founder of the Company, reallocated vested options to acquire 807,127 shares of the Company s common stock to certain of the Company s employees and a director. These reallocated options have a five-year term and are fully vested. As of March 31, 2006, 18,000 options remain outstanding with an exercise price of $7.00 per share. Non-cash compensation expense of $16,815,000 was recognized over the vesting periods from 2000 to 2002, representing the intrinsic value of the reallocated options based upon the difference between the fair market value of the Company s common stock on the dates the options were reallocated and the respective option exercise prices.

Executive Stock Option Agreements:

John A. Ryan In November 2001, Mr. John A. Ryan was appointed chairman, president and chief executive officer of the Company. Mr. Ryan received options to acquire 1,000,000 shares of ZixCorp common stock at an exercise price of $5.24 per share that became fully vested in November 2003 and were still outstanding on March 31, 2006. Mr. Ryan resigned as Chief Executive Officer and Chairman of the Board in February and October 2005, respectively.

Richard D. Spurr In January 2004, Mr. Richard D. Spurr was appointed president and chief operating officer of the Company. Mr. Spurr received options to acquire 650,000 shares of ZixCorp common stock at an exercise price of $10.80 per share. These options vested 25% in April 2004 and the remaining balance vests quarterly through January 2007 on a pro rata basis. The options automatically vest 100% in the event of a change in control of the Company. At March 31, 2006, all 650,000 options were still outstanding. Mr. Spurr was appointed Chief Executive Officer in March 2005, and Chairman of the Board in February 2006.

Other Executive Stock Option Agreements In 2001 and 2002 options to purchases 450,000 shares of common stock were granted to key company executives. The options have exercise prices ranging from $4.96 to $5.25 and became fully vested in March 2005. At March 31, 2006, 158,665 options remain outstanding.

Other Stock Option Agreements:

From time to time the Company may grant stock options to consultants, contractors and other third parties for services provided to the Company. These options are expensed based on their fair values as calculated by using the Black-Scholes Option Pricing Model (BSOPM). At March 31, 2006, options outstanding to non-employees were 285,000, of which 215,000 were granted from employee or director stock option plans and the remaining 70,000 issued under Other Stock Option Agreements.

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Accounting Treatment

On January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment*, and has elected to use the modified prospective method, which requires the application of the accounting standard to all share-based awards issued on or after January 1, 2006 and any outstanding share-based awards that were issued but not vested as of January 1, 2006. Accordingly, the condensed consolidated financial statements as of March 31, 2005 and for the three months then ended have not been restated to reflect the impact of SFAS 123(R).

For the quarter ended March 31, 2006, the adoption of FAS 123(R) resulted in incremental stock-based compensation expense of $767,000. This amount includes (i) compensation expense related to stock options granted prior to January 1, 2006, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123, and (ii) compensation expense for stock options granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. The incremental stock-based compensation expense caused loss before taxes and net loss to increase by $767,000 and basic and diluted net loss per share to increase by $0.02 per share.

For the quarter ended March 31, 2006, the total stock-based compensation expense of $767,000 was recorded to the following line items of the Company s condensed consolidated statement of operations:

Cost of revenues	$	33,000
Research and development expenses		32,000
Selling, general and administrative expenses		702,000
Stock-based compensation expense	$	767,000

There were no stock option exercises for the three months ended March 31, 2006; therefore, no excess tax benefits were recorded. A deferred tax asset totaling $291,000, resulting from stock-based compensation expense recognized in the first quarter 2006, was recorded and $277,000 of that total, which relates to stock option compensation costs for U.S. employees, was fully reserved as of March 31, 2006, because of the Company s historical net losses for its United States operations. The difference of $14,000, which relates to stock option compensation costs for Canadian employees, was recognized as an income tax benefit on the income statement for the period.

SFAS 123R requires the Company to calculate the pool of excess tax benefits, or the APIC (additional paid-in capital) pool, available as of January 1, 2006, to absorb tax deficiencies recognized in subsequent periods, assuming the Company had applied the provisions of the standard in prior periods. Pursuant to the provisions of FASB Staff Position 123R-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards,* the Company adopted the alternative method for determining the tax effects of share-based compensation, which among other things, provides a simplified method for estimating the beginning APIC pool balance.

Prior to the adoption of SFAS 123(R), the Company applied APB 25 to account for its stock-based awards. The following table details the effect on net income and earnings per share had compensation expense for employee stock-based awards been recorded in the first quarter of 2005 based on the fair value method under FAS 123:

		Three Months Ended March 31, 2005
Net loss, as reported	$	(9,572,000)
Deduct pro forma stock compensation expense computed under the fair value method		(1,761,000)
Pro forma net loss	$	(11,333,000)
Basic and diluted loss per common share:		
As reported	$	(0.30)

Pro forma	$	(0.35)

During the first quarter of 2006, the Company extended the contract life of 306,143 options held by one former director. As a result of this modification, the Company recognized an additional compensation expense of $34,000 in the period.

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As of March 31, 2006, there was $3,544,000 of total unrecognized stock based compensation related to nonvested share-based compensation awards granted under the stock option plans. This cost is expected to be recognized over a weighted average period of 1.16 years.

The Company used the Black-Scholes Option Pricing Model (BSOPM) to determine the fair value of option grants made during the first quarter of 2006 and 2005. The Company estimated the average holding period of vested options to be two years from the vesting period (1.6 years) for options granted before 2006, but used the simplified method per SEC Staff Accounting Bulletin No. 107 to calculate the estimated life of options granted to employees subsequent to December 31, 2005. The expected stock price volatility was calculated by averaging the historical volatility of the Company s common stock over the past six years. The following weighted average assumptions were applied in determining the fair value of options granted during the respective periods:

	Three Months Ended March 31,	
	2006	**2005**
Risk-free interest rate	4.58%	3.10%
Expected option life	6 years	3.6 years
Expected stock price volatility	97.5%	98.0%
Expected dividend yield		
Fair value of options granted	$ 1.34	$ 2.69

Stock Option Activity

The following is a summary of all stock option transactions for the three months ended March 31, 2006:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2006	7,595,415	$ 7.03		
Granted at market price	15,000	$ 1.93		
Granted above market price	1,871,944	$ 3.02		
Cancelled or expired	(611,300)	$ 7.24		
Exercised		$		
Outstanding at March 31, 2006	8,871,059	$ 6.16	7.00	$
Options exercisable at March 31, 2006	5,402,272	$ 7.47	7.00	$

At March 31, 2006, the Company had no stock options outstanding in which the exercise price was lower than the market value of the Company s common stock. Therefore, the intrinsic value is zero on all options.

The weighted average grant-date fair value of options granted during the quarters ended March 31, 2006, and 2005, was $1.34 and $2.69, respectively. A significant factor in the difference between these two valuations is the Company s 2006 practice of granting options with exercise prices in excess of the market price of the Company s common stock on the date of grant. The total intrinsic value of options exercised during the quarters ended March 31, 2006, and 2005, was not material in either period.

Common Stock Issued in Lieu of Cash

In the third quarter of 2003, the Company implemented a program whereby non-executive employees were paid certain incentive compensation, such as commissions, with Company common stock rather than cash. This program was authorized to grant 600,000 shares in-lieu of compensation. At December 31, 2005, all 600,000 shares of common stock had been granted under the program. In May 2005, shareholders approved an additional 500,000 shares for this program, which was expanded to include executive incentive pay as well. At March 31, 2006, 371,589 shares of common stock had been granted under the new program. During the first quarter of 2006 and 2005, the Company granted unrestricted shares of common stock of 94,720, and 69,555, respectively under this program. The common stock granted under this program had a weighted average fair value of $1.88 per share and $3.49 per share for the three months ended March 31, 2006, and 2005, respectively. The Company valued this stock at the fair value on the date of grant. For the quarters ended March 31, 2006 and 2005, the Company incurred non-cash expense relating to common stock issue in lieu of cash of $177,000 and $243,000, respectively, consisting of the following:

	Three Months Ended March 31,	
	2006	**2005**
Common stock issued to employees for compensation in lieu of cash	$ 157,000	$ 243,000
Stock granted to third parties	20,000	
Total	$ 177,000	$ 243,000

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6. Supplemental Cash Flow Information

Supplemental cash flow information relating to interest, taxes and noncash activities:

	Three Months Ended March 31,	
	2006	2005
Cash paid for interest	$ 102,000	$ 276,000
Cash paid for income tax	$	$ 220,000
Noncash investing and financing activities:		
Accrued expenses related to fixed asset purchases	$ 74,000	$
Value of additional warrants issued	$ 50,000	$
Insurance premiums financed by short-term note payable	$	$ 84,000

7. Business Sales and Acquisitions

Sale of Dr. Chart, a product of MyDocOnline

On September 30, 2005, the Company sold the remaining MyDocOnline product (Dr. Chart) to MITEM. As consideration, the Company received $150,000 in cash paid immediately after closing, a promissory note with a principal amount of $550,000 payable by mid-August 2007, and a warrant exercisable for 400,000 shares of MITEM common stock. Additionally, subject to the conditions and limitations provided in the Asset Purchase Agreement, MITEM assumed all Dr. Chart customer contracts and obligations upon close of the sale, including net deferred revenues of approximately $739,000. Subsequent to the closing of the transaction, the promissory note was adjusted to a principal amount of $540,000 pursuant to the terms of the sales agreement. The note principal is due in six equal quarterly payments of $90,000 beginning May 15, 2006, and bears interest at a rate of 10% per annum.

The promissory note issued by MITEM is fully reserved and no value has been assigned to the warrants received. Therefore, gains could be recorded in future periods should payments on the note receivable be received.

The following summarizes the carrying amount of assets and liabilities that were sold to or assumed by MITEM upon the close of the transaction, the allocation of the goodwill to the Dr. Chart product, and resulting loss from the sale:

Net assets sold (liabilities transferred):	
Accounts receivable, net	$ 34,000
Equipment, net	37,000
Intangibles, net	575,000
Deferred revenue	(739,000)
Net	(93,000)
Goodwill	4,797,000
Net proceeds:	
Cash receivable	150,000
Note receivable, net	
Service obligation	(30,000)
Transaction fees	(167,000)
Net proceeds	(47,000)

Loss on sale of product line	$ (4,751,000)

Revenues for the Dr. Chart product line were $70,000 for the quarter ended March 31, 2005. Dr. Chart did not represent a separate component of the Company as its operations and cash flows were not sufficiently separated from the rest of the Company; consequently, its results of operations are included in income from operations in the consolidated statements of operations.

The Company also agreed to provide customary indemnification to MITEM for breaches of representations and warranties, covenants and other specified matters. The Company has evaluated this indemnification and determined that no accrual is necessary.

Sale of Web Inspector and Message Inspector Product Lines

On March 11, 2005, the Web Inspector and Message Inspector product lines, which were acquired in the Elron acquisition, were sold to CyberGuard Corporation for $3,244,000 net of transactions fees of $317,000, consisting of $2,126,000 in cash and a $1,500,000 note receivable due in three equal payments of $500,000 on June 15, September 15 and December 15, 2005, with no stated interest rate. The note receivable was recorded at its present value of $1,435,000 using an imputed interest rate of 9%. This is estimated to approximate the rate which would have resulted if an independent borrower and an independent lender had negotiated a similar transaction under comparable terms and conditions. The resulting discount was amortized into interest income over the term of the note. CyberGuard paid the note in full in 2005.

The following summarizes the carrying amount of assets and liabilities that were sold to or assumed by CyberGuard upon the close of the transaction, the allocation of the goodwill associated with the portion of the email encryption reporting unit being sold, and the resulting gain from the sale:

Net assets sold (liabilities transferred):	
Equipment, net	$ 15,000
Prepaid expenses	165,000
Intangibles, net	1,499,000
Initial deferred revenue	(1,546,000)
Net	133,000
Goodwill	2,161,000
Net proceeds:	
Cash	2,126,000
Note receivable, net	1,435,000
Transaction fees	(317,000)
Net proceeds	3,244,000
Gain on sale of product lines	$ 950,000

In the quarter ended September 30, 2005, the Company agreed to transfer an additional $85,000 of deferred revenue to CyberGuard resulting in a total gain on the sale of MI/WI of $1,135,000 for the year ended December 31, 2005.

Revenues for the MI/WI product lines were $637,000 for the quarter ended March 31, 2005. MI/WI did not represent a separate component of the Company as its operations and cash flows were not sufficiently separated from the rest of the Company; consequently, their results of operations are included in income from operations in the consolidated statements of operations.

The Company also agreed to provide customary indemnification to CyberGuard for breaches of representations and warranties, covenants and other specified matters. The Company has evaluated this indemnification and determined that no accrual is necessary.

8. Restricted Cash and Marketable Securities

Current and noncurrent restricted cash of $5,137,000 at March 31, 2006, relates primarily to a debt covenant on the convertible promissory note payable requiring the Company to maintain a minimum of $5,000,000 on deposit through November 2006, at which time the required balance would be reduced to $2,500,000 through November 2007 (see Note 12).

9. Accounts Receivable

	March 31, 2006	December 31, 2005
Gross trade accounts receivable	$ 3,138,000	$ 3,136,000
Allowance for returns and doubtful accounts	(75,000)	(35,000)
Unpaid portion of deferred revenue	(2,964,000)	(2,969,000)
Trade receivables, net	99,000	132,000
Taxes receivable	297,000	
Other receivable	17,000	17,000
Total receivables, net	$ 413,000	$ 149,000

The above Unpaid portion of deferred revenue is a reduction for future customer service or maintenance obligations which are unpaid as of the respective balance sheet dates. Deferred revenue in current and long-term liabilities represents future customer service or maintenance obligations which have been billed and collected as of the respective balance sheet dates.

10. Intangible Assets and Goodwill

At March 31, 2006, the Company s intangible assets, all of which are subject to amortization, were comprised of the developed technology, which resulted from the third quarter 2003 acquisitions of PocketScript and the first quarter 2004 acquisition of MyDocOnline.

	March 31, 2006			December 31, 2005		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Developed technology	$2,034,000	$1,655,000	$379,000	$2,034,000	$1,475,000	$559,000

The weighted average useful life for developed technology is three years as of March 31, 2006 and 2005. Amortization expense relating to intangible assets totaled $180,000 and $444,000 for the quarters ended March 31, 2006 and 2005, respectively.

Changes in the intangible assets for the three-months ended March 31, 2006, were as follows:

	Cost	Accumulated Amortization
Beginning balance at January 1, 2006	$2,034,000	$1,475,000
Amortization of intangibles		180,000
Ending balance at March 31, 2006	$2,034,000	$1,655,000

The expected future intangible amortization expense is as follows:

Nine months ended December 31, 2006	$ 356,000
2007	23,000
Total	$ 379,000

At March 31, 2006, and December 31, 2005, the Company had recorded goodwill totaling $2,161,000 which was originally recorded with the acquisition of Elron Software in the third quarter 2003 and is assigned to the Email

Encryption segment. Goodwill of $2,161,000 was included in the carrying value of assets sold to CyberGuard in the sale of the Message Inspector and Web Inspector product lines (see Note 7). Goodwill of $4,797,000 was included in the carrying value of assets sold to MITEM in the sale of the MyDocOnline product line (see Note 7). The Company evaluates its goodwill for impairment annually in the fourth quarter, or when there is reason to believe that the value has been diminished or impaired. There have been no impairment indicators to the goodwill recorded as of March 31, 2006.

11. Customer Deposit

A Master Services Agreement was entered into with Sanofi-Aventis, Inc. (Sanofi-Aventis) for $4,000,000 in January 2004 for the Company s performance of various future services in conjunction with the MyDocOnline acquisition. The services were to be delivered in minimum amounts of $1,000,000, $1,000,000 and $2,000,000 prior to January 30, 2005, January 30, 2006, and January 30, 2007, respectively. The services will be defined on an ongoing basis over the life of the agreement and valued in accordance with pricing for similar services rendered by the Company to other customers. Sanofi-Aventis paid the $4,000,000 upon execution of the Master Services Agreement.

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Since the Company s services to be provided to Sanofi-Aventis were not fully defined, the $4,000,000 payment was recorded as a customer deposit. As the services are defined and priced in individual project agreements, the value of the defined element will be reclassified to deferred revenues and then recognized as revenue in accordance with applicable revenue recognition criteria. If the services are not requested by Sanofi-Aventis by the dates outlined above, the deposit will be forfeited on an annual basis and ZixCorp will recognize the forfeiture as a reduction of operating expenses. The Company is required to return to Sanofi-Aventis any unused portion of the deposit only in the event of material breach of the contract by the Company; in the event the Company or a party employed or engaged by the Company is debarred pursuant to the Generic Drug Enforcement Act of 1992 or similar state, local or foreign law; in the event the Company files for bankruptcy; or in the event of force majeure. The Company believes that it is unlikely any of these events will occur. The Company s obligations associated with the Master Services Agreement are secured by a first priority lien on the Company s property and equipment and accounts receivable. As of March 31, 2006, the Company has provided $40,000 of services to Sanofi-Aventis under this Master Services Agreement which was recognized as revenue in 2004.

Sanofi-Aventis has not requested any additional services through the first quarter of 2006, other than the $40,000 noted above. As such, $960,000 was forfeited by Sanofi-Aventis in the second quarter of 2005 and an additional $1,000,000 was forfeited in the first quarter of 2006. Both forfeitures are reported as customer deposit forfeitures and reduced operating expenses in the respective quarters. The Company believes that the forfeitures of deposit are most likely associated with a change in strategic direction that came about as a result of the merger between Sanofi and Aventis and the resulting change in personnel. The eventual disposition of the remaining customer deposit, $2,000,000 required to be used before January 30, 2007, is not known at this time.

The Company also holds an additional $20,000 customer deposit relating to separate customer agreements. This deposit is expected to be reclassified to deferred revenue and revenue recognition is expected to begin in 2006.

12. Notes Payable

Total notes payable at March 31, 2006 are as follows:

	Stated Interest Rate	**Effective Interest Rate**	**Term**	**December 31, 2005 Net Book Value**	**Additional Discount from Additional Warrants**	**Discount/ Premium Amortization**	**Payments Made**	**March 31, 2006 Net Book Value**
Convertible promissory notes payable	7.47%	34.51%	2007	$ 4,404,000	$ (40,000)	$ 140,000	$	$ 4,504,000
Promissory note payable	4.50%	11.00%	2007	2,226,000		104,000		2,330,000
Short-term promissory notes	6.99%	6.99%	2006	268,000			(76,000)	192,000
Total notes payable				$ 6,898,000	$ (40,000)	$ 244,000	$ (76,000)	$ 7,026,000

Convertible Promissory Notes Payable

On November 2, 2004, the Company entered into purchase agreements with Omicron Master Trust (Omicron) and Amulet Limited (Amulet , together with Omicron, the Investors), in which the Company issued and sold to the Investors $20,000,000 aggregate principal amount of secured, convertible notes and warrants to purchase 1,000,000 shares of the Company s common stock at an exercise price of $6.00 a share. The warrants are all exercisable and expire November 2, 2009. At the time the notes were issued, the Company s common stock had a fair value of $4.88 per share.

The Company incurred approximately $1,598,000 of financing costs associated with the original issuance of the convertible notes payable. This amount was deferred and is being amortized over the life of the notes using the effective interest method.

On April 13, 2005, the Company entered into amendments with the Investors to restructure the original purchase agreements signed on November 2, 2004. In connection with the restructuring of the notes, an Amended and Restated Convertible Note and an Amended and Restated Common Stock Purchase Warrant and an Amended and Restated Registration Rights Agreement were entered into with each of the Investors.

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Below is a summary of the significant terms of the notes as amended:

The principal was payable in four installments of $5,000,000 on October 31 and December 31, 2005 (collectivity, the 2005 Payments), November 2, 2006 and 2007.

The 2005 Payments could be redeemed at 105% of principal and could be redeemed in stock, in whole at any time or in part from time to time on or before the revised payment dates. The redemption value of the stock is based on the daily volume weighted average price (VWAP) of the common stock less a 10% discount for 15 trading days preceding the date of stock redemption. The amount of stock redeemed during any 15-day redemption period is limited to 20% of the volume of the Company s stock traded in the public market. Any portion of the 2005 payments which are not or cannot be redeemed in stock must be paid in cash at 105% of principal.

If the Company paid all or a portion of the 2005 Payments in cash, the Company must issue immediately exercisable warrants to the Investors equaling 70% of the common stock that would be issued to the Investors to retire that portion of the principal paid in cash at $6.00 per share (or lower exercise price if anti-dilution provisions are triggered). The exercise price of these warrants, if issued, would be $6.00 (or lower exercise price if anti-dilution provisions are triggered) and the warrants will expire on an annual basis beginning on November 2, 2006, and ending on November 2, 2008. These warrants would thereafter be subject to potential weighted average downward re-pricing triggered by future equity issuance by the Company at a price lower than $6.00 per share.

The 2006 and 2007 payments may be paid in stock if the Company s common stock closes above $6.00 per share for 15 of 20 days before the payment date and if the Company has enough shares available for issuance.

The Company has the right to prepay the 2006 and 2007 payments at any time at 105% of the outstanding principal amount of the notes, plus accrued interest if the Company is not in a share deficiency situation. In addition, the Company must issue immediately exercisable warrants to the Investors equaling 70% of the common stock that would be issued to the Investors to retire the principal and interest assuming the notes and interest were converted to the Company s common stock. The exercise price of these warrants, if issued, would be $6.00 a share, or lower if anti-dilution clauses are triggered.

The warrants to purchase 1,000,000 shares of the Company s common stock at an exercise price of $6.00 per share, were amended, such that the exercise price for a pro-rata portion of the warrants is reduced to the price of the Company s common stock as and when the convertible notes are redeemed in stock, if the redemption value per share of common stock is lower than $6.00 per share.

The notes stated interest rate is the six-month London Inter Bank Offering Rate (LIBOR) plus 300 basis points and is reset every six months (this rate was reset on November 1, 2005 to 7.47%).

At the Company s option, and assuming the Company has not reached the maximum shares allowed under the notes, interest on the notes is payable quarterly in cash or common stock valued at a 10% discount to the VWAP for the Company s common stock for a specified number of trading days preceding the interest payment date.

The Investors may convert the notes into the Company s common stock at $6.00 a share at any time. However, the Company has the right to force the conversion of the notes at $6.00 if the Company s common stock closes above $11.00 per share for 15 of 20 days before the annual payment date and if the following conditions are met:

1.

no "event of default" or "repurchase event," as such terms are defined in the convertible notes, under the notes has occurred;

2. there is an effective registration statement on file with the SEC covering the shares of stock to be issued with respect to the payment of principal and the registration statement has been effective during the 20 consecutive trading days preceding the principal payment date and is reasonably expected to be effective for at least 30 days following the issuance of the shares; and

3. 110% of the sum of the number of common stock shares to be issued to a particular holder on the scheduled principal payment date, plus the number of common stock shares previously issued to that holder, plus the number of common stock shares then issuable upon conversion of the note held by that holder or exercise of the warrants held by that holder is less than the portion of a maximum share amount allocated to such holder (initially 3,407,801 shares for each original note holder).

The notes have weighted average anti-dilution provisions that would cause an adjustment to the conversion price and the number of shares issuable under the notes upon the occurrence of issuances of equity securities or convertible equity securities at prices below the then-effective conversion price or other specified dilutive events such as stock splits, stock dividends, recapitalizations, certain repurchases by the Company of its shares, and certain dividends and distributions made by the Company.

The Investors have the right to require the Company to repurchase the notes in cash upon the occurrence of specified repurchase events, such as a change in control or events of default while the notes are outstanding. Additionally, the notes contain restrictive covenants, including covenants that prohibit the Company from incurring certain indebtedness, establishing certain liens on the Company s assets or issuing any variable priced securities.

The Company was required to place certain proceeds from the notes into a restricted collateral account. The amount of restricted cash collateral required to be maintained in this account is 50% of the aggregate principal amount outstanding. The Company was required to maintain an overall cash balance of $10,000,000 (restricted and non-restricted) through December 31, 2005, at which time the required cash balance was to be reduced to $9,000,000 at the time the December 31, 2005, payment was made. When the November 2, 2006, payment is made, the required cash balance was to be further reduced to $5,000,000 through the notes maturity.

Accounting treatment of the amended convertible promissory notes payable The amended convertible promissory notes payable as of April 13, 2005, were valued by an independent third party. The third party assessed the value of the 1,000,000 initial warrants issued with the notes at $2,225,000 using a binomial model calculation. The calculation assumed that the exercise price ranged from $3.76 $6.00 depending on the reset of the exercise price that occurs upon principal redemptions in stock. It also assumed a redemption level of $15.00 per share, a risk-free rate of 3.98%, volatility of 100% and the average remaining life of 4.5 years.

The Company accounted for the notes and related warrants using the provisions of EITF Abstract No. 00-19 *Accounting for Derivative Financial instruments Indexed to, and Potentially Settled in a Company s Own Stock* and Accounting Principles Board (APB) No. 14 *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants.* Under the provisions of EITF 00-19 the notes should be recorded as a liability as they do not meet the requirements of being accounted for as equity. Under the provisions of APB 14, the proceeds received from the notes should be allocated between the notes and the warrants based on their relative fair values at the time of issuance. Based on relative fair values at time the notes were amended, the total discount on the convertible notes payable as of April 13, 2005, was $2,086,000. This balance is being amortized to interest expense using the effective interest method over the remaining term of the notes.

The amended notes also contain a beneficial conversion feature resulting from the stock redemption being valued at the VWAP less 10%. Per EITF Abstract No. 98-5 *Accounting for Convertible Securities with Beneficial Conversion Features of Contingently Adjustable Conversion Features* and EITF Abstract No. 00-27 *Application of Issue No. 98-5 to Certain Convertible Instruments*, the beneficial conversion feature is valued using the intrinsic value method based on the net book value of the amended notes after all discounts are taken into effect. Using this approach, the intrinsic value of the beneficial conversion feature was calculated to be $2,518,000. This amount was allocated to the discount against the notes and additional paid-in capital in 2005. This balance was fully amortized to interest expense using the effective interest method through December 31, 2005, the date of the last payment to which the beneficial conversion feature is applicable.

The 5% early payment premium on the 2005 Payments noted above was accreted into interest expense using the effective interest method from the time of the amendment through the scheduled date of the last 2005 payment, December 31, 2005.

The Company incurred approximately $287,000 of costs in relation to the amendments to the convertible promissory notes. These costs were recorded as a period expense in the first quarter of 2005. However, the remaining unamortized balance of the financing costs incurred in relation to the issuance of the initial notes on November 2, 2004, continues to be reported as a deferred financing cost asset and amortized over the remaining life of the amended notes using the effective interest method.

2005 payment activity on the convertible promissory notes payable: Through a series of transactions beginning in May 2005, the Company made all 2005 Payments using a combination of common stock and cash. Approximately $1,951,000 of the total $10,000,000 2005 Payments were paid in cash. In accordance with the terms of the amended agreement, the Company issued 145,032 warrants equaling 70% of the common stock that would be issued to the investor to retire that portion of the principal paid in cash at $5.38 per share. These warrants were valued at $47,000 using the BSOPM with the following assumptions: expiration is 100% in November 2008, risk-free interest rate of 4.43%, volatility of 75% and no dividends payable during the life of the warrants.

On December 30, 2005, the Company transacted an early extinguishment of 50% of the outstanding balance of the convertible promissory notes payable ($5,000,000). As part of the partial debt extinguishment the Company paid the 5% early payment premium and all accrued interest. Additionally, per the amended terms of the notes, 650,558 warrants were issued equaling 70% of the common stock that would be issued to the investor to retire that portion of the principal paid in cash at $5.38 per share. These warrants were valued at $100,000 using the BSOPM with the following assumptions: expiration is 50% in November 2006 and 50% in November 2007, risk-free interest rate of 4.38%, volatility of 67 75% and no dividends payable during the life of the warrants.

After the all payments were made on the convertible promissory notes payable, the principal balance of the remaining note was $5,000,000 as of December 31, 2005, and there was no principal payment activity on the convertible notes during the quarter ended March 31, 2006. Principal payments of $2,500,000 are due on November 2, 2006, and November 2, 2007. All terms and conditions of the amended notes explained above apply to the remaining balances other than the restricted cash requirements. The Company is now required to maintain $5,000,000 in a collateral account through November 2, 2006, at which time it will be reduced to $2,500,000 when the required debt payment is made. The Company still has the option to make the final two payments with common stock assuming the Company s stock is at or above $6.00 for 15 of 20 days preceding the payment date; however, this would require shareholder approval of the issuance of additional shares as described below. Any cash payments will be made using the restricted cash balances on hand as of March 31, 2006.

Adjustments to the stock conversion price and warrant exercise price As noted in the terms above, the convertible promissory notes payable have certain weighted average anti-dilution clauses that adjust the debt conversion and warrant exercise pricing if the Company issues common stock below $6.00 per share. In the third quarter of 2005, the Company raised net proceeds of $24,201,000 through a private placement of common stock. As a result of this action, the number of warrants originally granted under the convertible promissory notes on November 2, 2004, increased from 1,000,000 to 1,115,244 and the exercise price of those warrants decreased from $6.00 per share to $5.38 per share. The conversion price of the convertible promissory note payable was also adjusted from $6.00 per share to $5.38 per share. The 115,244 additional warrants were valued at $153,000 using the BSOPM and recorded as additional discount on the convertible promissory note payable in 2005.

In the first quarter 2006, the Company issued under the anti-dilution clauses of the amended notes an additional 51,053 warrants valued at $50,000 using the BSOPM and the exercise price on the warrants declined from $5.38 to $5.24. This action also caused the conversion price on the existing note payable to decrease from $5.38 to $5.24.

Below is a summary of the additional warrants issued in the quarter ended March 31, 2006, relating to the convertible promissory notes payable (this table is not a summary of all warrants outstanding as of March 31, 2006, only those associated with the convertible promissory notes payable):

	December 31, 2005		March 31, 2006				
Warrant Grants:	**Warrants Outstanding**	**Exercise Price**	**Additional Warrants Issued**	**Allocation of Additional Warrants**	**Warrants Outstanding**	**Adjusted Exercise Price**	**Share Deficiency**
Convertible promissory notes payable, initial warrants	450,422	5.38			450,422	5.24	293,331
Increase due to repricing for 2005 Private Placement	115,244	5.38	29,796	(12,550)	132,490	5.24	17,246
Re-pricing of initial warrants, Sept 23, 2005	118,672	2.15		1,942	120,614	2.15	61,278
	87,442	1.82		1,432	88,874	1.82	45,153

Re-pricing of initial warrants, Oct 28, 2005							
Re-pricing of initial warrants, Dec 1, 2005	125,914	1.69		3,364	129,278	1.69	66,321
Re-pricing of initial warrants, Dec 9, 2005	217,550	1.44		5,812	223,362	1.44	104,089
Additional warrants issued due to 2005 cash payments on convertible promissory notes payable	795,590	5.38	21,257		816,847	5.24	218,040
Convertible promissory notes payable broker warrants	166,667	6.00			166,667	6.00	166,667
Total	2,077,501		(8,886)				

Proceeds from sales of fixed assets	883	133
Proceeds from dissolution of TSL joint venture	-	152
NET CASH USED IN INVESTING ACTIVITIES	(16,268)	(8,601)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Cash dividends paid	(12,800)	(12,795)
Proceeds from exercise of stock options	-	617
NET CASH USED IN FINANCING ACTIVITIES	(12,800)	(12,178)
Net increase (decrease) in cash and cash equivalents	(15,356)	3,590
Cash and cash equivalents at the beginning of the period	146,871	106,769
Cash and cash equivalents at the end of the period	$131,515	$110,359

See notes to condensed consolidated financial statements.

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Superior Industries International, Inc.
Condensed Consolidated Statement of Shareholders' Equity and Comprehensive Loss
(Dollars in thousands, except per share data)
(Unaudited)

	Common Stock Number of Shares	Common Stock Amount	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
BALANCE AT DECEMBER 28, 2008	26,668,440	$54,634	$ (67,244)	$484,203	$471,593
Comprehensive income (loss):					
Net loss	-	-	-	(90,211)	(90,211)
Other comprehensive income, net of tax:					
Foreign currency translation gain	-	-	7,296	-	7,296
Net actuarial gain on pension obligation	-	-	30	-	30
Total comprehensive loss					(82,885)
Stock-based compensation expense	-	1,698	-	-	1,698
Tax impact of stock options	-	(160)	-	-	(160)
Cash dividends declared ($0.48 per share)	-	-	-	(12,800)	(12,800)
BALANCE AT SEPTEMBER 27, 2009	26,668,440	$56,172	$ (59,918)	$381,192	$377,446

Comprehensive loss, net of tax was $(3,562) for the thirty-nine weeks ended September 28, 2008, which included: net loss of $(5,934), foreign currency translation adjustment gain of $2,302 and an unrealized gain of $70 on our pension obligation.

See notes to condensed consolidated financial statements.

Superior Industries International, Inc.
Notes to Condensed Consolidated Financial Statements
September 27, 2009
(Unaudited)

Note 1 – Nature of Operations

Headquartered in Van Nuys, California, the principal business of Superior Industries International, Inc. (referred to herein as the "company" or in the first person notation "we," "us" and "our") is the design and manufacture of aluminum road wheels for sale to original equipment manufacturers (OEM). We are one of the largest suppliers of cast and forged aluminum wheels to the world's leading automobile and light truck manufacturers, with wheel manufacturing operations in the United States, Mexico and Hungary. Customers headquartered in North America represent the principal market for our products. In addition, the majority of our sales to international customers are delivered primarily to their assembly operations in the United States.

Ford Motor Company (Ford), General Motors Corporation, or its successor, General Motors Company (GM) and Chrysler LLC or its successor, Chrysler Group LLC (Chrysler), together represented approximately 81 percent of our total wheel sales during the first three fiscal quarters of 2009 and 82 percent for the 2008 fiscal year. We also manufacture aluminum wheels for Audi, BMW, Jaguar, Land Rover, Mercedes Benz, Mitsubishi, Nissan, Seat, Skoda, Subaru, Suzuki, Toyota, Volkswagen and Volvo through our 50-percent owned joint venture in Europe. The loss of all or a substantial portion of our sales to Ford, GM or Chrysler would have a significant adverse impact on our operating results and financial condition, unless the lost volume could be replaced. This risk is partially mitigated by our long term relationships with these OEM customers and our supply arrangements which are generally for multi-year periods.

Beginning with the third quarter of 2008, the automotive industry was impacted negatively by the continued dramatic shift away from full-size trucks and SUVs caused by continuing high fuel prices, rapidly rising commodity prices and the tightening of consumer credit due to the then deteriorating U.S. financial markets. Accordingly, our customers announced unprecedented restructuring actions, including assembly plant closures, significant reductions in production of light trucks and SUVs, delayed launches of key 2009 model-year light truck programs and movement toward more fuel-efficient passenger cars and cross-over type vehicles. This was the first of five consecutive quarters with very difficult market conditions in the U.S. automotive industry. While we have had long-term relationships with our customers and our supply arrangements are generally for multi-year periods, the recent bankruptcy filings and resulting assembly plant closures and other restructuring activities by our customers have and will continue to have a negative impact on our business.

In addition to the financial situation of our key customers, we are also faced with adverse trends such as consumer shifts away from SUVs and trucks to more fuel-efficient vehicles and continued global competitive pricing pressures. These factors may make it more difficult to maintain long-term supply arrangements with our customers and there are no guarantees that supply arrangements could be negotiated on terms acceptable to us in the future. We expect the trends to more fuel-efficient vehicles and global competitive pricing pressures to continue into the foreseeable future.

The availability and demand for aluminum wheels are subject to unpredictable factors, such as changes in the general economy, the automobile industry, gasoline prices and consumer credit availability and interest rates. The raw materials used in producing our products are readily available and are obtained through numerous suppliers with whom we have established trade relations.

Note 2 – Presentation of Condensed Consolidated Financial Statements

During interim periods, we follow the accounting policies set forth in our 2008 Annual Report on Form 10-K and apply appropriate interim financial reporting standards for a fair statement of our operating results and financial position in conformity with accounting principles generally accepted in the United States of America, as codified in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) (U.S. GAAP), as indicated below. Users of financial information produced for interim periods in 2009 are encouraged to read this Quarterly Report on Form 10-Q in conjunction with our consolidated financial statements and notes thereto filed with the Securities and Exchange Commission (SEC) in our 2008 Annual Report on Form 10-K.

Interim financial reporting standards require us to make estimates that are based on assumptions regarding the outcome of future events and circumstances not known at that time, including the use of estimated effective tax rates. Inevitably, some assumptions will not materialize, unanticipated events or circumstances may occur which vary from those estimates and such variations may significantly affect our future results. Additionally, interim results may not be indicative of our results for future interim periods or our annual results.

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We use a 4-4-5 convention for our fiscal quarters, which are thirteen week periods generally ending on the last Sunday of each calendar quarter. We refer to these thirteen week fiscal periods as “quarters” throughout this report. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the SEC’s requirements for Form 10-Q and contain all adjustments, of a normal and recurring nature, which are necessary for a fair statement of (i) the condensed consolidated statements of operations for the thirteen and thirty-nine week periods ended September 27, 2009 and September 28, 2008, (ii) the condensed consolidated balance sheets at September 27, 2009 and December 28, 2008, (iii) the condensed consolidated statements of cash flows for the thirty-nine week periods ended September 27, 2009 and September 28, 2008, and (iv) the condensed consolidated statement of shareholders’ equity and comprehensive loss for the thirty-nine week period ended September 27, 2009. The condensed consolidated balance sheet as of December 28, 2008 was derived from our 2008 audited financial statements, but does not include all disclosures required by U.S. GAAP.

Note 3 – Impairment of Long-Lived Assets, Other Charges and Assets Held for Sale

Due to the deteriorating financial condition of our major customers and others in the automotive industry, we performed impairment analyses as of the end of the third quarter of 2009 on all long-lived assets in our operating plants, in accordance with FASB ASC 360 Property, Plant, and Equipment (Prior authoritative literature: Statement of Financial Accounting Standards (SFAS) No. 144, “Accounting for the Impairment of or Disposal of Long-Lived Assets”) (ASC 360). Our estimated undiscounted cash flow projections as of the end of the third quarter of 2009 exceeded the asset carrying values in all of our wheel manufacturing plants; therefore, no impairment was required to be made to our long-lived assets in our operating plants. Additionally, because our 50-percent owned joint venture in Hungary is also affected by these same economic conditions and certain other indicators of impairment, we performed an analysis of our investment in the joint venture, in accordance with FASB ASC 323 Investments – Equity Method and Joint Ventures (Prior authoritative literature: Accounting Principles Board Opinions (APB) No. 18, “The Equity Method of Accounting for Investments in Common Stock”) (ASC 323). This analysis also indicated that there was not an other than temporary impairment of this investment as of September 27, 2009. We will continue to monitor and perform updates of the impairment testing of our long-lived assets and our joint venture investment as long as impairment indicators are present.

We also performed impairment analyses at the end of the first quarter of 2009. Based on these analyses, we concluded that the estimated future undiscounted cash flows of our Fayetteville, Arkansas manufacturing facility would not be sufficient to recover the carrying value of our long-lived assets attributable to that facility. As a result, we recorded a pretax asset impairment charge against earnings totaling $8.9 million during the first quarter of 2009, reducing the $18.2 million carrying value of certain assets at this facility to their respective estimated fair values. The estimated fair values of the long-lived assets at our Fayetteville, Arkansas manufacturing facility were based, in part, on the estimated fair values of comparable properties. These assets are classified as held and used within the scope of ASC 360. We have classified the inputs to the nonrecurring fair value measurement of these assets as being Level 2 within the fair value hierarchy of FASB ASC 820 Fair Value Measurements and Disclosures (Prior authoritative literature: SFAS No. 157, “Fair Value Measurements” (as amended)) (ASC 820) utilizing the market approach.

In January 2009, we announced the planned closure of our wheel manufacturing facility located in Van Nuys, California in an effort to further reduce costs and more closely align our capacity with sharply lower demand for aluminum wheels by the automobile and light truck manufacturers. The facility ceased operations at the end of the second quarter of 2009, resulting in the layoff of approximately 290 employees. A pretax asset impairment charge against earnings totaling $10.3 million, reducing the $10.8 million carrying value of certain assets at the Van Nuys manufacturing facility to their respective fair values, was recorded in the fourth quarter of 2008, when we concluded that the estimated future undiscounted cash flows of that operation would not be sufficient to recover the carrying value of our long-lived assets attributable to that facility. One-time termination benefits and other shutdown costs related to this plant closure are estimated to approximate $6.6 million, of which $1.6 million was recorded in the third quarter and $5.1 million for the first three quarters of 2009. Costs for one-time termination benefits included in cost of sales totaled $0.1 million in the third quarter and $2.3 million for the first three quarters. These one-time termination benefits are derived from the individual agreements with each employee and are being accrued for ratably over the requisite service period. As of September 27, 2009, our liability for one-time termination benefits related to the closure of the Van Nuys, California manufacturing facility totaled $0.4 million, which was included in accrued expenses in our condensed consolidated balance sheet. Payments for one-time termination benefits related to the closure of this facility totaled $0.4 million in the third quarter of 2009 and $2.1 million for the first three quarters of 2009. All other shutdown costs were expensed and paid as incurred.

We also recorded a total of $0.1 million in the third quarter of 2009 and $2.4 million for the first three quarters of 2009 for one-time termination benefits costs related to workforce reductions at several of our other facilities. These amounts were also recorded in cost of sales in our condensed consolidated statement of operations and substantially all of these costs were paid in full as of September 27, 2009.

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During the second quarter of 2009, we accepted an offer for the sale of our Johnson City, Tennessee facility, at a selling price below its current carrying value. As a result, during that period we recorded a reduction in our carrying value of this facility by $0.6 million to its estimated fair value of $2.2 million. Additionally, subsequent to the end of the second quarter, we received some indications, based on equipment sales that occurred subsequent to June 28, 2009, that the carrying values of the held for sale equipment from our Pittsburg, Kansas, and Van Nuys, California, facilities, totaling $2.6 million, were higher than current market values. Consequently, we recorded an additional impairment charge of $1.9 million to reduce the carrying value of this equipment to its new estimated fair value. We have classified the above nonrecurring fair value measurements as Level 1 inputs within the fair value hierarchy of ASC 820 utilizing the market approach. Due to plant shutdowns and the realignment of our business to match our current production needs, we have identified, and are in the processof selling, specific long-lived assets from our former manufacturing operations in Van Nuys, California, Johnson City, Tennessee, and Pittsburg, Kansas. These assets, which totaled $7.0 million at September 27, 2009, are classified as assets held for sale in accordance with ASC 360.

Note 4 – Stock-Based Compensation

Our 2008 Equity Incentive Plan authorizes us to issue incentive and non-qualified stock options, as well as stock appreciation rights, restricted stock and performance units to our non-employee directors, officers, employees and consultants totaling up to 3.5 million shares of common stock. No more than 100,000 shares may be used under such plan as “full value” awards, which include restricted stock and performance units. It is our policy to issue shares from authorized but not issued shares upon the exercise of stock options. At September 27, 2009, there were 2.9 million shares available for future grants under this plan. Options are granted at not less than fair market value on the date of grant and expire no later than ten years after the date of grant. Options granted under this plan require no less than a three year ratable vesting period.

During the first three quarters of 2009, we granted options for a total of 622,500 shares, compared to 616,000 options granted during the first three quarters of 2008. In the first three quarters of 2009, a valuation allowance was established for the income tax benefit on our stock based compensation expense. The weighted average fair value at the grant date for options issued during the first three quarters of 2009 and 2008 was $3.95 per option and $5.30 per option, respectively. The fair value of options at the grant date was estimated utilizing the Black-Scholes valuation model with the following weighted average assumptions for 2009 and 2008, respectively: (a) dividend yield on our common stock of 3.68 percent and 3.23 percent; (b) expected stock price volatility of 37.3 percent and 30.5 percent; (c) a risk-free interest rate of 3.03 percent and 3.41 percent; and (d) an expected option term of 6.9 years and 7.0 years. During the first three quarters of 2009, no options were exercised compared to options for 35,000 shares exercised during the same period in 2008.

Stock-based compensation expense related to our stock option plans under FASB ASC 718 Compensation – Stock Compensation (Prior authoritative literature: SFAS No. 123R (revised 2004), “Share-Based Payment”) was allocated as follows:

(Dollars in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
Cost of sales	$98	$34	$259	$243
Selling, general and administrative	482	490	1,439	1,488
Stock-based compensation expense before income taxes	580	524	1,698	1,731

Income tax (benefit)	-	(154)	-	(508)
Stock-based compensation expense after income taxes	$580	$370	$1,698	$1,223

As discussed in Note 9 – Income Taxes, we established a valuation allowance on our deferred tax assets in the first quarter of 2009. Consequently, the income tax benefit on our stock based compensation expense in the first three quarters of 2009 was entirely offset by the valuation allowance. As of September 27, 2009, a total of $5.3 million of unrecognized compensation cost related to non-vested awards is expected to be recognized over a weighted average period of approximately 2.66 years. There were no significant capitalized stock-based compensation costs at September 27, 2009 and December 28, 2008. There were no stock options exercised during the first three quarters of 2009. Proceeds from stock options exercised during the first three quarters of 2008 totaled $617,000.

Note 5 - New Accounting Standards

In December 2007, the FASB issued FASB ASC 805 Business Combinations (Prior authoritative literature: SFAS No. 141(R), "Business Combinations" which replaced SFAS No. 141, "Business Combinations") (ASC 805). This statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. ASC 805 applies to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of the applicable provisions of ASC 805 as of January 1, 2009 did not have a material impact on our consolidated results of operations or statement of financial position or disclosures.

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In February 2008, the FASB decided to issue a final Staff Position to allow a one-year deferral of adoption of ASC 820 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The ASC 820 excludes FASB ASC 840 Leases and its related interpretive accounting pronouncements that address leasing transactions. We adopted ASC 820 effective January 1, 2009 for nonrecurring fair value measurements of nonfinancial assets and liabilities and have included the required discussion in Note 3 – Impairment of Long-lived Assets, Other Charges and Assets Held for Sale and Note 17 – Risk Management.

In March 2008, the FASB issued FASB ASC 815 Derivatives and Hedging (Prior authoritative literature: SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities", an amendment of FASB Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities") (ASC 815). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. Entities with instruments subject to ASC 815 must provide more robust qualitative disclosures and expanded quantitative disclosures. ASC 815 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of the applicable provisions of ASC 815 as of January 1, 2009, did not have a material impact on our consolidated results of operations or statement of financial position.

In November 2008, the FASB ratified ASC 323, which clarifies the accounting for certain transactions and impairment considerations involving equity method investments. ASC 323 is effective for fiscal years beginning after December 15, 2008. The adoption of the applicable provisions of ASC 323 as of January 1, 2009, did not have a material impact on our consolidated results of operations or statement of financial position or disclosures.

During May 2009, the FASB issued FASB ASC 855 Subsequent Events (Prior authoritative literature: SFAS No. 165, "Subsequent Events") (ASC 855), to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. ASC 855 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. This statement is effective for interim or annual financial periods ending after June 15, 2009. We adopted ASC 855 during our second fiscal quarter and it had no impact on results of operations or financial position. In the preparation of the condensed consolidated financial statements, we evaluated subsequent events after the balance sheet date of September 27, 2009 through November 6, 2009.

In June 2009, the FASB issued FASB ASC 810 Consolidation (Prior authoritative literature: SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)") (ASC 810) which changes the approach in determining the primary beneficiary of a variable interest entity (VIE) and requires companies to more frequently assess whether they must consolidate VIEs. ASC 810 is effective for annual periods beginning after November 15, 2009. We are evaluating the impact, if any, the adoption of ASC 810 will have on our consolidated financial statements.

In June 2009, the FASB issued FASB ASC 105 General Accepted Accounting Principles (Prior authoritative literature: SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162,") (ASC 105). ASC 105 establishes the FASB Accounting Standards Codification (Codification) as the source of authoritative U.S. GAAP for nongovernmental entities. The Codification, which does not change U.S. GAAP, takes the thousands of individual pronouncements that currently comprise U.S. GAAP and reorganizes them into approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with "FASB ASC," where ASC stands for Accounting Standards Codification. ASC 105 is effective for interim and annual periods ending after September 15, 2009 and will not have an impact on the Company's financial position but will change the referencing system for accounting standards.

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Note 6 – Business Segments

The Chairman and Chief Executive Officer is our chief operating decision maker (CDOM). The CDOM evaluates both consolidated and disaggregated financial information at each manufacturing facility in deciding how to allocate resources and assess performance. Each manufacturing facility functions as a separate cost center, manufactures the same products, ships product to the same group of customers, utilizes the same cast manufacturing process and as a result, production can be transferred among our facilities. Accordingly, we operate as a single integrated business and, as such, have only one operating segment - automotive wheels. Net sales and net property, plant and equipment by geographic area are summarized below.

(Dollars in thousands)

	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
Net sales:	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
U.S.	$32,620	$96,568	$101,110	$342,030
Mexico	78,751	66,786	172,695	260,947
Consolidated net sales	$111,371	$163,354	$273,805	$602,977

Property, plant and equipment, net:	September 27, 2009	December 28, 2008
U.S.	$49,479	$80,016
Mexico	130,910	136,193
Consolidated property, plant and equipment, net	$180,389	$216,209

Note 7 - Revenue Recognition

Sales of products and any related costs are recognized when title and risk of loss transfers to the purchaser, generally upon shipment. Tooling reimbursement revenues, representing internal development expenses and initial tooling expenses that are reimbursable by our customers, are recognized as such related costs and expenses are incurred and recoverability is probable, generally upon receipt of a customer purchase order. Tooling reimbursement revenues included in net sales totaled $1.8 million and $4.1 million for the third quarters of 2009 and 2008, respectively. Tooling reimbursement revenues included in net sales totaled $6.3 million and $14.3 million for the first three quarters of 2009 and 2008, respectively.

Note 8 – Loss Per Share

In accordance with the provisions of FASB ASC 260 Earnings Per Share (Prior authoritative literature: SFAS No. 128, "Earnings Per Share") basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share includes the dilutive effect of outstanding stock options, calculated using the treasury stock method.

Of the 3.6 million stock options outstanding at September 27, 2009, 3.5 million shares had an exercise price greater than the weighted-average market price of the stock for the thirteen week and thirty-nine week periods ended September 27, 2009 and were excluded in the calculations of diluted loss per share for the period. In addition, options to purchase the remaining 0.1 million shares for the thirteen and thirty-nine week periods ended September 27, 2009 were excluded from diluted loss per share calculation, because they were anti-dilutive due to the net loss in each period.

Of the 3.5 million stock options outstanding at September 28, 2008, 2.7 million shares had an exercise price greater than the weighted-average market price of the stock for the thirteen week ended September 28, 2008, and 2.4 million shares had an exercise price greater than the weighted average price of the stock for the thirty-nine week period ending September 28, 2008. In addition, options to purchase the remaining 0.8 million shares for the thirteen and 1.1 million shares for the thirty-nine week periods ended September 28, 2008 were excluded from diluted loss per share calculation, because they were anti-dilutive due to the net loss in each period.

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Summarized below are the calculations of basic and diluted loss per share for the respective periods:

(Dollars in thousands, except per share amounts)	Thirteen Weeks Ended September 27, 2009	Thirteen Weeks Ended September 28, 2008	Thirty-Nine Weeks Ended September 27, 2009	Thirty-Nine Weeks Ended September 28, 2008
Basic Loss per Share:				
Reported net loss	$(12,741)	$(14,207)	$(90,211)	$(5,934)
Basic loss per share	$(0.48)	$(0.53)	$(3.38)	$(0.22)
Weighted average shares outstanding - Basic	26,668	26,661	26,668	26,650
Diluted Loss per Share:				
Reported net loss	$(12,741)	$(14,207)	$(90,211)	$(5,934)
Diluted loss per share	$(0.48)	$(0.53)	$(3.38)	$(0.22)
Weighted average shares outstanding	26,668	26,661	26,668	26,650
Weighted average dilutive stock options	-	-	-	-
Weighted average shares outstanding - Diluted	26,668	26,661	26,668	26,650

Note 9 – Income Taxes

Income taxes are accounted for pursuant to FASB ASC 740 Income Taxes (Prior authoritative literature: SFAS No. 109, "Accounting for Income Taxes") (ASC 740) which requires the use of the liability method and the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities. The effect on deferred taxes for a change in tax rates is recognized in income in the period of enactment. Provision is made for U.S. income taxes on undistributed earnings of international subsidiaries and our 50-percent owned joint venture, unless such future earnings are considered permanently reinvested. Tax credits are accounted for as a reduction of the provision for income taxes in the period in which the credits arise.

In considering whether a valuation allowance was required for our U.S. federal deferred tax assets when preparing our Annual Report on Form 10-K for the year ended December 28, 2008, we considered all positive and negative evidence available at the time of filing. At that time, we concluded the positive evidence outweighed the negative evidence, including continued deterioration of the automotive industry as part of the negative evidence. We also indicated that if our future results and projections were less than projected at that time, a substantial valuation allowance might be required in the near term.

In accordance with ASC 740, we determined in the first quarter of 2009 that a valuation allowance was required to reduce our U.S. federal deferred tax asset. In addition to the cumulative U.S. tax losses for the past three years, and the expectation of a U.S. tax loss in 2009, we considered, among other factors, the announcements of filing for bankruptcy by Chrysler and prolonged plant closures by GM and Chrysler, which severely limited our ability to identify objectively verifiable positive evidence to support the likelihood of the realization of this deferred tax asset. Further, the current volatility of the automotive industry creates significant uncertainty and subjectivity to the timing of our profitability in future periods. Under these circumstances, ASC 740 imposes a strong presumption that a valuation allowance is required in the absence of objectively verifiable information. Consequently, in considering the weight of all positive and negative evidence available as of the date of our 10-Q filing for the first quarter, we recorded a valuation allowance of $25.3 million against our beginning deferred tax asset, which was reflected as a charge against tax expense in the first quarter of 2009.

We continued to evaluate all positive and negative evidence available at the time of filing this quarterly report. At this time, we have concluded that a valuation allowance is still required due to the cumulative U.S. tax losses for the past three years, and the expectations of U.S. tax losses in the current year, as well as the anticipated contraction in the automotive industry in the foreseeable future. We also determined that any deferred tax assets generated during the year would be reserved for by establishing a valuation allowance against them.

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Due to the termination of certain tax examinations during the third quarter, we recognized the benefit of previously unrecognized tax benefits in the amount of $11.1 million, which was reflected as a credit against tax expense in the current quarter. Within the next twelve month period ending September 26, 2010, we do not anticipate recognizing any of the $44.0 million liability established for unrecognized tax benefits, which includes interest and penalties, due to the expiration of statutes of limitations and terminations of examinations.

The reversal during the third quarter of this portion of our liability for our unrecognized tax benefits reduced our estimate of future taxable income, resulting in a need to increase our valuation allowance by $12.2 million to reduce the carrying balance of our U.S. deferred tax assets to an amount that is more likely than not recoverable. This increase in the valuation allowance was reflected as a charge against income tax expense during the third quarter of 2009.

During the third quarter we also determined that we will not be able to recognize the benefit of certain net operating losses in Mexico because we have forecasted that we will be subject to the Business Flat Tax during the periods in which the net operating losses are expected to be utilized. As a result, we recorded a valuation allowance of $8.2 million against the deferred tax assets related to the Mexican net operating losses, of which $6.3 million was recorded as income tax expense, and $1.9 million was recorded through other comprehensive income.

The income tax (provision) benefit on income before income taxes and equity earnings for the thirty-nine weeks ended September 27, 2009 was a provision of $(32.4) million, including the $(43.8) million impact of the valuation allowance described above, compared to a benefit of $3.2 million for the thirty-nine week period ended September 28, 2008.

We conduct business internationally and, as a result, one or more of our subsidiaries file income tax returns in U.S. federal, U.S. state and certain foreign jurisdictions. Accordingly, in the normal course of business, we are subject to examination by taxing authorities throughout the world, including taxing authorities in Hungary, Mexico, the Netherlands and the United States. On July 28, 2009, we received notification from the United States' Joint Committee on Taxation of final approval of tax years 2003 through 2007. We are no longer under examination of any U.S. federal, state and local income tax returns for years before 2008.

The 2003 income tax return of Superior Industries de Mexico S.A. de C.V, our wholly-owned Mexican subsidiary, is currently under review by Mexico's Tax Administration Service (Servicio de Administracion Tributaria). Also during the third quarter, we received notification that Mexico's Tax Administration Service had begun reviewing the documentation supporting our tax positions for the year 2004.

Note 10 – Equity in Earnings of Joint Venture

Included below are summary statements of operations for Suoftec, our 50-percent owned joint venture in Hungary, which manufactures cast and forged aluminum wheels principally for the European automobile industry. Being 50-percent owned and non-controlled, Suoftec is not consolidated, but accounted for using the equity method.

(Dollars in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
Net sales	$21,284	$30,350	$59,926	$113,495
Cost of sales	27,631	30,658	72,734	106,804
Gross profit (loss)	(6,347)	(308)	(12,808)	6,691
Selling, general and administrative expenses	459	623	1,360	2,084
Income (loss) from operations	(6,806)	(931)	(14,168)	4,607

Other income (expense), net	(281)	(331)	(698)	702
Income (loss) before income taxes	(7,087)	(1,262)	(14,866)	5,309
Income tax (provision) benefit	(1,291)	291	60	(930)
Net income (loss)	$(8,378)	$(971)	$(14,806)	$4,379
50-percent of Suoftec net income (loss)	$(4,189)	$(485)	$(7,403)	$2,189
Intercompany profit elimination	117	342	185	373
Equity in earnings (loss) of Suoftec	$(4,072)	$(143)	$(7,218)	$2,562

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Note 11 – Restricted Cash Deposits

Due to the tightened credit conditions and the recent turmoil in the automotive industry, the financial institutions that we do business with have required that we maintain various deposits as a compensating balance in the event of our default on certain obligations. We purchased a total of $1.2 million in certificates of deposit during the quarter that mature within the next twelve months that are used to secure our workers' compensation obligations in lieu of collateralized letters of credit. These certificates of deposit are classified as short term investments on our condensed consolidated balance sheet. We also purchased $3.5 million in certificates of deposit during the quarter that mature at the end of 2010 that are used to secure our natural gas contracts in Mexico. These certificates of deposit are classified as long-term investments in the other assets line of our condensed consolidated balance sheet. All of the aforementioned cash deposits were either not required or were not the most economical form to secure our obligations during the previous quarters. It is our intention to eliminate any restricted cash deposits in the future when credit conditions return to normal and other forms of securitization become more economically feasible.

The purchase of $1.2 million of short-term certificates of deposit and the purchase of $3.5 million of long-term certificates of deposit have been classified as investing activities in our condensed consolidated statement of cash flows for the thirty-nine weeks ended September 27, 2009.

Note 12 – Accounts Receivable

(Dollars in thousands)

	September 27, 2009	December 28, 2008
Trade receivables	$76,166	$82,647
Tooling reimbursement receivables	3,763	4,628
Other receivables	5,858	5,279
	85,787	92,554
Allowance for doubtful accounts	(1,424)	(3,128)
Accounts receivable, net	$84,363	$89,426

Shortly after the bankruptcy filings by Chrysler on April 30, 2009 and by GM on June 1, 2009, both customers designated us as a key supplier, indicating that all pre- and post-petition accounts receivable would be paid in accordance with payment terms existing prior to the bankruptcy filing dates. The pre-petition accounts receivable for the Chrysler and GM entities that filed for bankruptcy totaled $2.9 million and $7.2 million, respectively, as of the dates of filings. As of September 27, 2009 less than $0.1 million of the total pre-petition accounts receivable remain unpaid.

Note 13 – Inventories

(Dollars in thousands)

	September 27, 2009	December 28, 2008
Raw materials	$4,009	$12,755
Work in process	17,091	22,266
Finished goods	24,381	35,094
Inventories, net	$45,481	$70,115

Note 14 – Property, Plant and Equipment

(Dollars in thousands)

	September 27, 2009	December 28, 2008
Land and buildings	$68,245	$86,600
Machinery and equipment	382,073	464,674
Leasehold improvements and others	8,429	9,359
Construction in progress	6,853	18,728
	465,600	579,361
Accumulated depreciation	(285,211)	(363,152)
Property, plant and equipment, net	$180,389	$216,209

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Depreciation expense was $7.9 million for the thirteen weeks ended September 27, 2009 compared to $11.4 million for the same period ended September 28, 2008. Depreciation expense was $23.4 million for the thirty-nine weeks ended September 27, 2009 compared to $34.3 million for the same period ended September 28, 2008. The impairment charges are recorded in the appropriate fixed assets cost categories in the table above as discussed in Note 3 – Impairment of Long-lived Assets, Other Charges and Assets Held for Sale.

Note 15 – Retirement Plans

We previously had individual Salary Continuation Agreements with all of our directors, officers, and other key members of management who are participants in our unfunded supplemental executive retirement program. Due to recent changes in the tax laws, payments made under this program could be subject to substantial new taxes for the participants, which may be avoided if these agreements are amended or are replaced by a plan that complies with such law changes. In the first quarter of 2008, we offered affected participants the opportunity to terminate their individual Salary Continuation Agreements and become a participant in a new unfunded Salary Continuation Plan (Plan), which now covers all subsequent participants. The terms of both the Salary Continuation Agreements and the Plan provide that after having reached specified vesting dates and after reaching the age of 65 (or in the event of death while in the employ of the company prior to separation from service), the company will pay to the individual, upon ceasing to be employed by the company for any reason, a benefit equal to 30 percent of the individual's final average compensation over the preceding 36 months. Final average compensation only includes base salary. The benefit is paid weekly and continues for the retiree’s remaining life or for a minimum of ten years.

For the thirty-nine weeks ended September 27, 2009, payments to retirees or their beneficiaries approximating $679,000 have been made. We presently anticipate benefit payments in 2009 to total approximately $899,000.

(Dollars in thousands)	Thirteen Weeks Ended		Thirty-Nine Weeks Ended	
	September 27, 2009	September 28, 2008	September 27, 2009	September 28, 2008
Service cost	$224	$118	$671	$353
Interest cost	302	289	905	867
Net amortization	15	42	46	126
Net periodic pension cost	$541	$449	$1,622	$1,346

Note 16 – Commitments and Contingencies

Derivative Litigation

In late 2006, two shareholder derivative complaints were filed, one each by plaintiffs Gary B. Eldred and Darrell D. Mack, based on allegations concerning some of the company’s past stock option grants and practices. These cases were subsequently consolidated as In re Superior Industries International, Inc. Derivative Litigation, which is pending in the United States District Court for the Central District of California. In the plaintiffs’ consolidated complaint, filed on March 23, 2007, the company was named only as a nominal defendant from whom the plaintiffs sought no monetary recovery. In addition to naming the company as a nominal defendant, the plaintiffs named various present and former employees, officers and directors of the company as individual defendants from whom they sought monetary and/or equitable relief, purportedly for the benefit of the company.

Plaintiffs purported to base their claims against the individual defendants on allegations that the grant dates for some of the options granted to certain company directors, officers and employees occurred prior to upward movements in the stock price, and that the stock option grants were not properly accounted for in the company’s financial reports and not properly disclosed in the company's SEC filings. The company and the individual defendants filed motions to dismiss plaintiffs' consolidated complaint on May 14, 2007. In an order dated August 9, 2007, the court granted our motion to dismiss the consolidated complaint, and granted the plaintiffs leave to file an amended complaint.

On August 29, 2007, the plaintiffs filed an amended consolidated complaint that was substantially similar to the prior consolidated complaint. In response, the company and the individual defendants filed motions to dismiss on September 21, 2007. In an order dated April 14, 2008, the court again granted our motion to dismiss the amended consolidated complaint, with leave to amend. On May 5, 2008, the plaintiffs filed a second amended consolidated shareholder derivative complaint that alleges claims substantially similar to the prior complaints. Once again, the company and the individual defendants filed motions to dismiss on May 30, 2008. The court conducted a hearing on the motions to dismiss on September 15, 2008 but has yet to rule on the motions. Discovery is stayed in the case pending resolution of motions to dismiss.

On October 9, 2009, the parties entered into and filed with the court a stipulation of compromise and settlement which sets forth the terms and conditions of a proposed settlement of the consolidated shareholder derivative litigation. In connection with the proposed settlement, the company has agreed to adopt or maintain a variety of improved corporate governance measures, including practices and procedures for granting stock options and to release its officers, directors and employees from liability based on the matters alleged in the litigation. A hearing for preliminary approval of the proposed settlement is scheduled for November 9, 2009. We continue to anticipate that the resolution of this matter will not have a material adverse effect on our financial position or results of operations.

Air Quality Matters

The South Coast Air Quality Management District (the SCAQMD) issued to us notices of violation (NOVs) on December 14, 2007 and in late 2008 and early 2009, alleging violations of certain permitting and air quality rules at our Van Nuys, California manufacturing facility. Throughout 2008 and 2009, we worked closely with the SCAQMD to achieve compliance and we took all steps necessary to remedy the issues associated with these violations. On September 22, 2009, we entered into a settlement agreement with the SCAQMD that required us to pay a civil penalty of $50,000 in exchange for a release from all liability with regard to any condition at the facility prior to June 30, 2009.

Other

We are party to various other legal and environmental proceedings incidental to our business. Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against us. Based on facts now known, we believe all such matters are adequately provided for, covered by insurance, are without merit and/or involve such amounts that would not materially adversely affect our consolidated results of operations, cash flows or financial position.

For additional information concerning contingencies, risks and uncertainties we face, see Note 17 – Risk Management.

Note 17 – Risk Management

We are subject to various risks and uncertainties in the ordinary course of business due, in part, to the competitive global nature of the industry in which we operate, changing commodity prices for the materials used in the manufacture of our products, and the development of new products.

The functional currencies of our foreign operations in Mexico and Hungary are the Mexican peso and the euro, respectively. We have foreign operations in Mexico and Hungary that, due to the settlement of accounts receivable and accounts payable, require the transfer of funds denominated in their respective functional and legal currencies – the Mexican peso and the euro. The value of the Mexican peso increased by 2 percent in relation to the U.S. dollar in the first three quarters of 2009. The euro experienced an increase of 4 percent versus the U.S. dollar in the first three quarters of 2009. Foreign currency transaction gains in the third quarter of 2009 totaled $0.7 million compared to a gain of $1.2 million in the same period a year ago. For the first three quarters of 2009, we had foreign currency transaction losses totaling $1.0 million compared to a loss of $0.5 million in 2008. All transaction gains and losses are included in other income (expense) in the consolidated statement of operations.

As it relates to foreign currency translation gains and losses, however, since 1990, the Mexican peso has experienced periods of relative stability followed by periods of major declines in value. The impact of these changes in value relative to our Mexico operations has resulted in a cumulative unrealized translation loss at September 27, 2009 of $65.6 million. Since our initial investment in our joint venture in Hungary in 1995, the fluctuations in functional currencies have resulted in a cumulative unrealized translation gain at September 27, 2009 of $7.5

million. Translation gains and losses are included in other comprehensive income (loss) in the consolidated statements of shareholders’ equity and comprehensive loss.

When market conditions warrant, we may also enter into contracts to purchase certain commodities used in the manufacture of our products, such as aluminum, natural gas and other raw materials in order to mitigate commodity price risk. Typically, any such commodity commitments are expected to be purchased and used over a reasonable period of time in the normal course of business. Accordingly, such normal purchase/normal sale (NPNS) commitments are not subject to the provisions of ASC 815, unless there is a change in the facts or circumstances in regard to the probability of taking full delivery of the contracted quantities.

We currently have several purchase agreements for the delivery of natural gas through 2012. With the recent closure of our manufacturing facility in Van Nuys, California in June 2009, and the completed closure in December 2008 of our manufacturing facility in Pittsburg, Kansas, we will no longer qualify for the NPNS exemption provided for under ASC 815 for the remaining natural gas purchase commitments related to those facilities. In addition, we have concluded that the natural gas purchase commitments for our manufacturing facility in Arkansas and certain natural gas commitments for our facilities in Chihuahua, Mexico no longer qualify for the NPNS exemption provided for under ASC 815 since we can no longer assert that it is probable we will take full delivery of these contracted quantities in light of the continued decline of our industry. In accordance with ASC 815, these natural gas purchase commitments are classified as being with "no hedging designation" and, accordingly, we are required to record any gains and/or losses associated with the changes in the estimated fair values of these commitments in our current earnings. The contract and fair values of these purchase commitments classified as "no hedging designation" at September 27, 2009 were \$10.7 million and \$6.9 million, respectively, which represents a gross liability of \$3.8 million, of which \$3.2 million was included in accrued expenses and the remaining \$0.6 million was included in other non-current liabilities in our September 27, 2009 condensed consolidated balance sheet. The gains and losses on these commitments totaled a gain of \$1.2 million in the third quarter of 2009 and a loss of \$2.2 million for the first three quarters of 2009 which were included in cost of sales of our 2009 condensed consolidated statement of operations.

Based on the quarterly analysis of our estimated future production levels, certain natural gas purchase commitments with a contract value of \$10.0 million and a fair value of \$7.6 million for our manufacturing facilities in Mexico continue to qualify for the NPNS exemption provided for under ASC 815, since we can assert that it is probable we will take full delivery of the contracted quantities. The contract and fair values of all natural gas purchase commitments were \$20.7 million and \$14.5 million, respectively, at September 27, 2009. As of December 28, 2008, the aggregate contract and fair values of natural gas commitments were approximately \$28.0 million and \$21.1 million, respectively. Percentage changes in the market prices of natural gas will impact the fair values by a similar percentage.

The recurring fair value measurement of the natural gas purchase commitments are based on quoted market prices using the market approach and the fair value is determined based on Level 1 inputs within the fair value hierarchy provided for under ASC 820.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by us or on our behalf. We may from time to time make written or oral statements that are "forward-looking" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, including statements contained in this report and other filings with the SEC and other reports and public statements. These statements may, for example, express expectations or projections about future actions or results that we may anticipate but, due to developments beyond our control, do not materialize. Actual results could differ materially because of issues and uncertainties such as those listed herein, which, among others, should be considered in evaluating our financial outlook. The principal factors that could cause our actual performance and future events and actions to differ materially from such forward-looking statements include, but are not limited to, changes in the automotive industry, including the financial distress of our OEM customers and changes in consumer preferences for end products, fluctuations in production schedules for vehicles for which we are a supplier, increased global competitive pressures, our dependence on major customers and third party suppliers and manufacturers, our ability to achieve cost savings from reductions in manufacturing capacity, our exposure to foreign currency fluctuations, increasing fuel prices and other factors or conditions described in Item 1A – Risk Factors in Part II of this Quarterly Report on Form 10-Q and in Item 1A – Risk Factors in Part I of our 2008 Annual Report on Form

10-K. We assume no obligation to update publicly any forward-looking statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying Condensed Consolidated Financial Statements and notes thereto.

Executive Overview

Beginning with the third quarter of 2008, the automotive industry was impacted negatively by the continued dramatic shift away from full-size trucks and SUVs caused by continuing high fuel prices, rapidly rising commodity prices and the tightening of consumer credit due to the then deteriorating U.S. financial markets. Accordingly, our OEM customers announced unprecedented restructuring actions, including assembly plant closures, significant reductions in production of light trucks and SUVs, delayed launches of key 2009 model-year light truck programs and movement toward more fuel-efficient passenger cars and cross-over type vehicles. This was the first of five consecutive quarters with very difficult market conditions in the U.S. automotive industry. While we have had long-term relationships with our customers and our supply arrangements are generally for multi-year periods, the recent bankruptcy filings and resulting assembly plant closures and other restructuring activities by our customers have and will continue to negatively impact our business.

As we began the third quarter of 2009, Chrysler had just emerged from bankruptcy on June 10, followed by GM on July 11. The majority, if not all, of Chrysler's and GM's assembly plants were closed during their bankruptcy proceedings. During the first and second quarters of 2009, the extremely difficult market conditions in the U.S. auto industry highlighted by the further deterioration of market demand for cars and light trucks in North America resulted in our unit shipments decreasing by 55 percent and 52 percent, respectively, compared to the comparable periods in 2008. Unit shipments in the third quarter of 2009 decreased 10 percent compared to the same period in 2008.

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We have taken steps to manage our costs in order to rationalize our production capacity after the announcements over the last five fiscal quarters by our major customers of assembly plant closures and sweeping production cuts, particularly in the light truck and SUV platforms. In August 2008, we announced the planned closure of our wheel manufacturing facility located in Pittsburg, Kansas, and workforce reductions in our other North American plants, resulting in the layoff of approximately 665 employees and the elimination of 90 open positions. On January 13, 2009, we also announced the planned closure of our Van Nuys, California wheel manufacturing facility, thereby eliminating an additional 290 jobs. The Kansas and California facilities ceased operations in December 2008 and June 2009, respectively.

Our customers continue to request price reductions as they work through their own financial challenges. We are engaged in ongoing programs to reduce our own costs through process automation and identification of industry best practices, and we have been successful in substantially mitigating pricing pressures in the past. However, it has become increasingly more difficult to react quickly enough given the continuing pressure for price reductions, reductions in customer orders, and the lengthy transitional periods necessary to reduce labor and other costs. As such, our profit margins will continue to be lower than our historical levels. We will continue to strive to increase our operating margins from current operating levels by aligning our plant capacity with industry demand and aggressively implementing cost-saving strategies to enable us to meet customer-pricing expectations. However, as we incur costs to implement these strategies, the initial impact on our future financial position, results of operations and cash flow may be negative. Additionally, even if successfully implemented, these strategies may not be sufficient to offset the impact of on-going pricing pressures and additional reductions in customer demand in future periods.

Overall North American production of passenger cars and light trucks in the third quarter was reported by industry publications as being down approximately 21 percent versus the same period a year ago, with production of passenger cars decreasing 33 percent while production of light trucks and SUVs decreased 6 percent. The U.S. automotive industry continued to be impacted negatively by extended assembly plant closures, the lack of available consumer credit as a result of the deterioration of the U.S. financial markets and overall recessionary economic conditions in the U.S.

Consolidated revenues in the third quarter of 2009 decreased \$52.0 million, or 32 percent, to \$111.4 million from \$163.4 million in the same period a year ago. Wheel sales decreased \$49.7 million, or 31 percent, to \$109.6 million from \$159.3 million in the third quarter a year ago, as our wheel shipments decreased 10 percent. Following two consecutive quarters when unit shipments approximated 1.4 million wheels, the lowest level for any quarter since the first quarter of 1992, unit shipments increased to approximately 2.0 million wheels in the third quarter of 2009. Gross profit in the current quarter was \$4.2 million, or 4 percent of net sales, compared to a loss of \$(11.2) million, or (7) percent of net sales, in the same period a year ago. The net loss after income taxes and equity earnings for the period was \$(12.7) million, or \$(0.48) per diluted share, compared to a net loss in 2008 of \$(14.2) million, or \$(0.53) per diluted share.

We believe that our sales in the third quarter of 2009 were positively impacted by increased production, as both GM and Chrysler began to return to more normalized production levels following their emergence from Chapter 11 bankruptcy protection. We also believe that automotive production generally was positively impacted by increased consumer demand for new automobiles, largely driven by the federal government's Car Allowance Rebate System, also known as "cash for clunkers". However, no assurance can be given as to the sustainability of positive impacts, as economic conditions remain relatively weak and the appropriations for the cash for clunkers program were exhausted in August 2009.

Results of Operations

(Dollars in thousands, except per share amounts)

Selected data	Thirteen Weeks Ended September 27, 2009	Thirteen Weeks Ended September 28, 2008	Thirty-Nine Weeks Ended September 27, 2009	Thirty-Nine Weeks Ended September 28, 2008
Net sales	$111,371	$163,354	$273,805	$602,977
Gross profit (loss)	$4,222	$(11,191)	$(22,347)	$10,248
Percentage of net sales	3.8%	-6.9%	-8.2%	1.7%
Loss from operations	$(1,559)	$(22,422)	$(50,545)	$(14,093)
Percentage of net sales	-1.4%	-13.7%	-18.5%	-2.3%
Net loss	$(12,741)	$(14,207)	$(90,211)	$(5,934)
Percentage of net sales	-11.4%	-8.7%	-32.9%	-1.0%
Diluted loss per share	$(0.48)	$(0.53)	$(3.38)	$(0.22)

Impairment of Long-Lived Assets and Other Charges

Due to the deteriorating financial condition of our major customers and others in the automotive industry, we performed impairment analyses as of the end of the third quarter of 2009 on all long-lived assets in our operating plants, in accordance with FASB ASC 360 Property, Plant, and Equipment (Prior authoritative literature: Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment of or Disposal of Long-Lived Assets") (ASC 360). Our estimated undiscounted cash flow projections as of the end of the third quarter of 2009 exceeded the asset carrying values in all of our wheel manufacturing plants; therefore, no impairment was required to be made to our long-lived assets in our operating plants. Additionally, because our 50-percent owned joint venture in Hungary is also affected by these same economic conditions and certain other indicators of impairment, we performed an analysis of our investment in the joint venture, in accordance with FASB ASC 323 Investments – Equity Method and Joint Ventures (Prior authoritative literature: Accounting Principles Board Opinions (APB) No. 18, "The Equity Method of Accounting for Investments in Common Stock") (ASC 323). This analysis also indicated that there was not an other than temporary impairment of this investment as of September 27, 2009. We will continue to monitor and perform updates of the impairment testing of our long-lived assets and our joint venture investment as long as impairment indicators are present.

Based on the impairment analyses performed at the end of the first quarter of 2009, we concluded that the estimated future undiscounted cash flows of our Fayetteville, Arkansas manufacturing facility would not be sufficient to recover the carrying value of our long-lived assets attributable to that facility. As a result we recorded a pretax asset impairment charge against earnings totaling $8.9 million during the first quarter of 2009, reducing the $18.2 million carrying value of certain assets at this facility to their respective estimated fair values. The estimated fair values of the long-lived assets at our Fayetteville, Arkansas manufacturing facility were based, in part, on the estimated fair values of comparable properties. These assets are classified as held and used within the scope of ASC 360. We have classified the inputs to the nonrecurring fair value measurement of these assets as being Level 2 within the fair value hierarchy of FASB ASC 820 Fair Value Measurements and Disclosures (Prior authoritative literature: Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements" (as amended)) (ASC 820), utilizing the market approach.

In January 2009, we announced the planned closure of our wheel manufacturing facility located in Van Nuys, California in an effort to further reduce costs and more closely align our capacity with sharply lower demand for aluminum wheels by the automobile and light truck manufacturers. The facility ceased operations at the end of the second quarter of 2009, resulting in the layoff of approximately 290 employees. A pretax asset impairment charge against earnings totaling $10.3 million, reducing the $10.8 million carrying value of certain assets at the Van Nuys manufacturing facility to their respective fair values, was recorded in the fourth quarter of 2008, when we concluded that the estimated future undiscounted cash flows of that operation would not be sufficient to recover the carrying value of our long-lived assets attributable to that facility. One-time termination benefits and other shutdown costs related to this plant closure are estimated to approximate $6.6 million, of which $1.6 million was recorded in the third quarter and $5.1 million for the first three quarters of 2009. Costs for one-time termination benefits included in cost of sales totaled $0.1 million in the third quarter and $2.3 million for the first three quarters. These one-time termination benefits are derived from the individual agreements with each employee and are being accrued for ratably over the requisite service period. As of September 27, 2009, our liability for one-time termination benefits related to the closure of the Van Nuys, California manufacturing facility totaled $0.4 million, which was included in accrued expenses in our condensed consolidated balance sheet. Payments for one-time termination benefits related to the closure of this facility totaled $0.4 million in the third quarter of 2009 and $2.1 million for the first three quarters of 2009. All other shutdown costs were expensed and paid as incurred.

We also recorded a total of $0.1 million in the third quarter of 2009 and $2.4 million for the first three quarters of 2009 for one-time termination benefits costs related to workforce reductions at several of our other facilities. These amounts were also recorded in cost of sales in our condensed consolidated statement of operations and substantially of these costs were paid in full as of September 27, 2009.

During the second quarter of 2009, we accepted an offer for the sale of our Johnson City, Tennessee facility, at a selling price below its current carrying value. As a result, during that period we reduced our carrying value of this facility by $0.6 million to its estimated fair value of $2.2 million. Additionally, subsequent to the end of the second quarter, we received some indications, based on equipment sales that occurred subsequent to June 28, 2009, that the carrying values of the held for sale equipment from our Pittsburg, Kansas, and Van Nuys, California, facilities, totaling $2.6 million, were higher than current market values. Consequently, we recorded an additional impairment charge of $1.9 million to reduce the carrying value of this equipment to its new estimated fair value. We have classified the above nonrecurring fair value measurements as Level 1 inputs within the fair value hierarchy of ASC 820 utilizing the market approach. Due to plant shutdowns and the realignment of our business to match our current production needs, we have identified, and are in the process of selling, specific long-lived assets from our former manufacturing operations in Van Nuys, California, Johnson City, Tennessee, and Pittsburg, Kansas. These assets, which totaled $7.0 million at September 27, 2009, are classified as assets held for sale in accordance with ASC 360.

Sales

Consolidated revenues in the third quarter of 2009 decreased $52.0 million, or 31.8 percent, to $111.4 million from $163.4 million in the same period a year ago. Wheel sales decreased $49.7 million, or 31.2 percent, to $109.6 million from $159.3 million in the third quarter a year ago, as our wheel shipments decreased by 9.7 percent. The average selling price of our wheels decreased approximately 23.8 percent in the current quarter due primarily to a 21.0 percent decrease in the pass-through price of aluminum. Tooling reimbursement revenues totaled $1.8 million in the third quarter of 2009 and $4.1 million in the third quarter of 2008. The decrease in tooling reimbursement revenues in the current quarter was due to a lower volume of new wheel development programs during 2009.

Consolidated revenues in the first three quarters of 2009 decreased $329.2 million, or 54.6 percent, to $273.8 million from $603.0 million in the same period a year ago. Wheel sales decreased $321.2 million, or 54.6 percent, to $267.5 million from $588.7 million in the first three quarters a year ago, as our wheel shipments decreased by 41.9 percent. The average selling price of our wheels during the first nine months of 2009 decreased approximately 21.8 percent due to a 16.7 percent decrease in the pass-through price of aluminum and a 5.1 percent decrease in the average selling price due to a shift in sales mix. Tooling reimbursement revenues totaled $6.3 million in the first three quarters of 2009 and $14.3 million in the same period of 2008. This decrease was due primarily to a lower volume of new wheel development programs during 2009.

As reported by industry publications, North American production of passenger cars and light trucks in the third quarter was down approximately 21 percent compared to the same quarter in the previous year, while our wheel shipments fell 10 percent for the same period. The decline of North American production included a decrease of 33 percent for passenger cars, while light trucks fell by 6 percent. During the same period, our shipments of passenger car wheels decreased by 35 percent while light truck wheel shipments increased by 19 percent.

Due to the timing of the GM and Chrysler assembly plants reopening following their emergence from their respective Chapter 11 bankruptcy filings, wheel shipments in the third quarter of 2009 to GM were 34 percent of total shipments compared to 45 percent a year ago, and wheel shipments to Chrysler were 13 percent of total shipments compared to 14 percent in 2008. Wheel shipments to Ford increased to 35 percent of total shipments compared to 21 percent a year ago. Wheel shipments to our international customers in the third quarter of 2009 were 18 percent of total shipments compared to 20 percent a year ago.

Our shipments to GM decreased 32 percent in the third quarter of 2009 compared to the same period a year ago, as shipments of passenger car wheels to GM decreased 67 percent and light truck wheel shipments to GM decreased 12 percent. The major unit shipment decreases to GM were for the Chevy Trailblazer, Cadillac CTS and GMC Acadia. The larger increases in wheel shipments to GM were for the GMT800/900 platform and the Cadillac Denali/Escalade.

Shipments to Chrysler decreased 16 percent in the third quarter of 2009 compared to the same period a year ago, as shipments of passenger car wheels to Chrysler decreased 40 percent and shipments of light truck wheels to Chrysler increased 8 percent. The major decreases in unit shipments were for the Chrysler Sebring and Dodge Magnum/Charger. The larger increases in wheel shipments to Chrysler were for the Dodge Caravan and Journey.

Shipments to Ford increased 51 percent in the third quarter of 2009 compared to the same period a year go, as shipments of passenger car wheels to Ford decreased 5 percent and light truck wheel shipments to Ford increased 207 percent. The major increases in unit shipments were for F Series trucks, Fusion and Explorer. The larger unit shipment decreases were for the Mustang and Mercury MKZ / Zephyr.

Shipments to international customers decreased 17 percent in the third quarter of 2009 compared to a year ago, as shipments of passenger car wheels decreased 27 percent to international customers and shipments of light truck wheels to international customers increased 12 percent. The principal unit shipment decreases to international customers in the current period compared to a year ago were for Nissan’s Altima, Mitsubishi Galant and the Toyota Vibe, while the larger unit shipment increases were for the Subaru-Isuzu Legacy / Outback and Toyota Highlander.

Gross Profit (Loss)

Consolidated gross profit for the third quarter of 2009 was $4.2 million, or 3.8% of net sales, compared to a loss of $(11.2) million, or (6.9) percent of net sales, for the same period a year ago. As indicated above, unit shipments in the third quarter of 2009 decreased 9.7 percent compared to the same period a year ago, while wheels produced decreased 16 percent compared to the same period a year ago. In spite of these decreases in both unit shipments and wheels produced, and the one-time costs identified below, our gross profit improved by $15.4 million, due to the steps taken beginning in the third quarter of 2008 to manage our costs and rationalize our production capacity in line with the changes announced by our major customers. Our manufacturing workforce decreased 42 percent in the third quarter of 2009 compared to the same period a year ago. Approximately 50 percent of this reduction was due to the closure of the Pittsburg, Kansas and Van Nuys, California facilities, with the remaining 50 percent due to other workforce reductions in our existing five manufacturing facilities in the U.S. and Mexico. Accordingly, labor and related fringe costs in the third quarter of 2009 were 53 percent lower than a year ago. In addition, due to implementation of other cost controls during this period, all other manufacturing expenses were reduced by an average of 39 percent.

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One-time termination benefit costs related to the California plant closure included in gross profit during the third quarter totaled approximately $0.1 million. Other non-impairment costs associated with plant closures and other workforce reduction costs included in gross profit during the quarter totaled $2.7 million. Additionally, for the third quarter of 2009, workers compensation and medical claims expenses related to our plant closures were $1.9 million higher than in the same period a year ago. Due to improved market prices of natural gas in the third quarter of 2009, the net impact on gross profit of our forward natural gas contracts that had previously been marked to market was an increase of $0.8 million to gross profit.

Consolidated gross profit (loss) for the first three quarters of 2009 decreased $32.6 million to a loss of $(22.3) million, or (8.2) percent of net sales, compared to a gross profit of $10.2 million, or 1.7 percent of net sales, for the same period a year ago. The slowdown in the general economy in early 2009 and the bankruptcy filings and extended assembly plant shutdowns by Chrysler and GM contributed to the 41.9 percent decrease in unit shipments and the 42.8 percent decrease in wheel production in the first three quarters of 2009 compared to the same period in 2008. For the first three quarters of 2009, our manufacturing workforce decreased 41 percent compared to the same period a year ago, with 46 percent of the reduction due to the plant closures. Labor and related fringe costs in 2009 decreased 54 percent and all other manufacturing expenses decreased 42 percent, all in line with our unit shipment and production decreases. However, the lost margin on the decreased shipments and the one-time costs identified below resulted in the significant decrease in gross profit for the first three quarters of 2009 compared to the same period a year ago.

One-time termination benefit costs related to the Van Nuys plant closure included in gross profit during the first three quarters totaled approximately $2.3 million. Other non-impairment costs associated with plant closures and other workforce reduction costs included in gross profit during the first three quarters totaled $7.2 million. For the first three quarters of 2009, workers compensation and medical claims expenses related to our plant closures were $4.5 million. For the first three quarters of 2009, the net impact on gross profit (loss) of the forward natural gas contracts previously marked to market was a net charge of $2.9 million.

We are continuing to implement action plans to improve our operational performance and mitigate the impact of the declines in U.S. auto industry production and the continuing pricing environment in which we now operate on our operating results and financial condition. While we continue to reduce costs through process automation and identification of industry best practices, the pace of auto production declines and global pricing pressures may continue at a rate faster than our progress on achieving cost reductions for an indefinite period of time. This is due to the inherently time-consuming nature of developing and implementing these cost reduction programs. In addition, although we have a portion of our natural gas requirements covered by fixed-price contracts expiring through 2012, costs may increase to a level that cannot be immediately recouped in selling prices. The impact of these factors on our future operating results and financial condition and cash flows may be negative, to an extent that cannot be predicted, and we may not be able to implement sufficient cost-saving strategies to mitigate any future impact.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the third quarter of 2009 decreased $0.4 million to $5.8 million, or 5.2 percent of net sales, from $6.2 million, or 3.8 percent of net sales, in the same period in 2008. This was primarily due to a decrease of $0.5 million in the third quarter of 2009 in salaries and related fringe benefits, due to personnel reductions during the latter part of 2008 and the early part of 2009. For the first three quarters of 2009, selling, general and administrative expenses were $16.4 million, or 6.0 percent of net sales, compared to $19.3 million, or 3.2 percent of net sales, for the same period in 2008. The principal reductions in the year-to-date period were $1.2 million in salaries and related fringes, $1.0 million in lease and related facility costs, and $0.9 million in the provision for doubtful accounts.

Equity in Earnings (Loss) of Joint Venture

Equity in earnings of joint venture represents our share of the equity earnings of our 50-percent owned joint venture in Hungary, Suoftec. Our share of Suoftec's net loss in the third quarter of 2009 was $(4.2) million compared to a loss of $(0.5) million for the same period in 2008. Including adjustments for the elimination of intercompany profits in inventory, our adjusted equity earnings of this joint venture was a loss of $(4.1) million in the third quarter of 2009 and a loss of $(0.1) million in the third quarter of 2008.

Our joint venture was negatively impacted by customer restructurings and the economic conditions affecting the automotive industry in Europe. Net sales decreased $9.1 million, or 30 percent, to $21.3 million in the third quarter of 2009 compared to $30.4 million for the same period last year. The decrease in net sales was due to an 18 percent decrease in units shipped, along with a 15 percent decrease in the average selling price in U.S. dollars. However, the average selling price in euros, the functional currency of the joint venture, declined only 9 percent and the U.S. dollar/euro exchange rate decreased 6 percent. Net sales for the first three quarters of 2009 decreased by $53.6 million, or 47 percent, to $59.9 million compared to $113.5 million for the same period in 2008. The decrease in net sales for the year-to-date period was due to a 37 percent decrease in units shipped and a 16 percent decrease in the average selling price in U.S. dollars. However, the average selling price in euros decreased only 6 percent and the euro to U.S. dollar exchange rate decreased 11 percent during the period.

Gross profit (loss) in the third quarter decreased to a loss of $(6.3) million, or (29.8) percent of net sales, compared to a loss of $(0.3) million, or (1.0) percent of net sales, for the same quarter of last year. Gross profit (loss) for the first three quarters of 2009 decreased $19.5 million to a loss of $(12.8) million, or (21.4) percent of net sales, from a profit of $6.7 million, or 5.9 percent of net sales, in the same period a year ago. The main contributors to the decrease in gross profit this quarter compared to the same quarter last year were the lost margin on the decreased unit shipments and the inability to absorb fixed costs due to the resulting decrease in production. Other items decreasing gross profit in the current period were a higher than normal amount of rework necessary to correct quality issues and higher costs for maintenance and operating supplies. These same factors contributed to the year-to-date decrease in gross profit.

Selling, general and administrative expenses this quarter decreased to $0.5 million from $0.6 million in the same quarter last year. The $0.1 million decrease in selling, general and administrative expenses was due principally to lower sales commissions. Selling, general and administrative expenses for the first three quarters of 2009 decreased $0.7 million to $1.4 million from $2.1 million in the same period last year. The decrease in selling, general and administrative expenses was principally due to the 11 percent decrease in the average euro to U.S. dollar exchange rate and decreases in sales commissions.

Due principally to the decrease in gross profit explained above and the establishment of a $1.2 million valuation reserve in the current quarter against deferred tax assets resulting from Suoftec’s net operating losses, Suoftec’s net income decreased to a loss of $(8.4) million in the third quarter of 2009 compared to a loss of $(1.0) million in the same quarter last year. Net loss for the first three quarters of 2009 was $(14.8) million compared to net income of $4.4 million in the same period a year ago.

Income Tax (Provision) Benefit

The income tax (provision) benefit on income before income taxes and equity earnings for the thirty-nine weeks ended September 27, 2009 was a provision of $(32.4) million, including the $(43.8) million impact of the valuation allowance described below, compared to a benefit of $3.2 million for the thirty-nine week period ended September 28, 2008.

In accordance with FASB ASC 740 Income Taxes (Prior authoritative literature: SFAS No. 109, “Accounting for Income Taxes”) (ASC 740), we determined in the first quarter of 2009 that a valuation allowance was required to reduce our U.S. federal deferred tax asset. In addition to the cumulative U.S. tax losses for the past three years, and the expectation of a U.S. tax loss in the current year, we considered, among other factors, the announcements of filing for bankruptcy by Chrysler and prolonged plant closures by GM and Chrysler, which severely limited our ability to identify objectively verifiable positive evidence to support the likelihood of the realization of this deferred tax asset. Further, the current volatility of the automotive industry creates significant uncertainty and subjectivity to the timing of profitability in future periods. Under these circumstances, ASC 740 imposes a strong presumption that a valuation allowance is required in the absence of objectively verifiable information. Consequently, in considering the weight of all positive and negative evidence available as of the date of our 10-Q filing, we recorded a valuation allowance of $25.3 million, which was reflected as a charge against tax expense in the first quarter of 2009.

Due to the termination of certain tax examinations during the third quarter, we recognized the benefit of previously unrecognized tax benefits in the amount of $11.1 million, which was reflected as a credit against tax expense in the current quarter. Within the next twelve month period ending September 26, 2010, we do not anticipate recognizing any of the $44.0 million liability established for unrecognized tax benefits, which includes interest and penalties, due to the expiration of statutes of limitations and terminations of examinations.

The reversal during the third quarter of this portion of our liability for our unrecognized tax benefits reduced our estimate of future taxable income, resulting in a need to increase our valuation allowance by $12.2 million to reduce the carrying balance of our U.S. deferred tax assets to an amount that is more likely than not recoverable. This increase in the valuation allowance was reflected as a charge against income tax expense during the third quarter of 2009.

During the third quarter we also determined that we will not be able to recognize the benefit of certain net operating losses in Mexico because we have forecasted that we will be subject to the Business Flat Tax during the periods in which the net operating losses are expected to be utilized. As a result, we recorded a valuation allowance of $8.2 million against the deferred tax assets related to the Mexican net operating losses, of which $6.3 million was recorded as income tax expense, and $1.9 million was recorded through other comprehensive income.

Financial Condition, Liquidity and Capital Resources

Our sources of liquidity include cash, cash equivalents, short-term investments, net cash provided by operating activities and other external sources of funds. Working capital and our current ratio were $241.3 million and 4.8:1, respectively, at September 27, 2009, versus $257.1 million and 5.1:1 at December 28, 2008. We have no long-term debt. As of September 27, 2009, our cash, cash equivalents and short-term investments totaled $137.7 million, which included $1.2 million in restricted cash deposits, compared to $146.9 million at December 28, 2008 and $110.4 million at September 28, 2008.

The increase in cash, cash equivalents and short-term investments since September 28, 2008 was due principally to reduced funding requirements of accounts receivable and inventories. For the foreseeable future, we expect all working capital requirements, funds required for investing activities and cash dividend payments to be funded from internally generated funds or existing cash, cash equivalents and short-term investments. The increase in cash provided by operating activities and in cash, cash equivalents and short-term investments experienced in the first nine months of 2009 may not necessarily be indicative of future results.

Net cash provided by operating activities decreased $10.7 million to $13.7 million for the thirty-nine weeks ended September 27, 2009, compared to $24.4 million provided during the same period a year ago. The change in net income plus the changes in non-cash items decreased net cash provided by operating activities by $37.9 million. This decrease was partially offset by the net change in working capital requirements and other operating assets and liabilities, totaling $27.2 million. Funding requirements for accounts receivable and accounts payable accounted for $4.3 million and $19.0 million, respectively, of the working capital change.

Our principal investing activities during the thirty-nine weeks ended September 27, 2009 were funding $7.4 million of capital expenditures and the purchase of $9.7 million of certificates of deposit, which due to their respective maturity dates were classified as short-term investments - $6.2 million - and long-term assets - $3.5 million. Due to the tightened credit conditions, $4.7 million of the $9.7 million of certificates of deposit purchased during the quarter were required by the financial institutions that we do business with as compensating balances in the event of our default on our workers' compensation and natural gas contract obligations. It is our intention to eliminate any restricted cash deposits in the future when credit conditions return to normal and other forms of securitization become more economically feasible. Similar investing activities during the same period a year ago included funding $8.9 million of capital expenditures. The capital expenditures in both periods were for ongoing improvements to our existing facilities, none of which were individually significant.

Financing activities during the thirty-nine weeks ended September 27, 2009 and September 28, 2008 consisted primarily of the payment of cash dividends on our common stock totaling $12.8 million in both periods. In addition, $0.6 million of proceeds were received from the exercise of stock options during the thirty-nine weeks ended

September 28, 2008.

Critical Accounting Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to apply significant judgment in making estimates and assumptions that affect amounts reported therein, as well as financial information included in this Management's Discussion and Analysis of Financial Condition and Results of Operations. These estimates and assumptions, which are based upon historical experience, industry trends, terms of various past and present agreements and contracts, and information available from other sources that are believed to be reasonable under the circumstances, form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent through other sources. There can be no assurance that actual results reported in the future will not differ from these estimates, or that future changes in these estimates will not adversely impact our results of operations or financial condition.

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New Accounting Standards

In December 2007, the FASB issued FASB ASC 805 Business Combinations (Prior authoritative literature: SFAS No. 141(R), "Business Combinations" which replaced SFAS No. 141, "Business Combinations") (ASC 805). This statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as the date that the acquirer achieves control. ASC 805 applies to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of the applicable provisions of ASC 805 as of January 1, 2009 did not have a material impact on our consolidated results of operations or statement of financial position or disclosures.

In February 2008, the FASB decided to issue a final Staff Position to allow a one-year deferral of adoption of ASC 820 for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The ASC 820 excludes FASB ASC 840 Leases and its related interpretive accounting pronouncements that address leasing transactions. We adopted ASC 820 effective January 1, 2009 for nonrecurring fair value measurements of nonfinancial assets and liabilities and have included the required discussion in Note 3 – Impairment of Long-lived Assets, Other Charges and Assets Held for Sale and Note 17 – Risk Management.

In March 2008, the FASB issued FASB ASC 815 Derivatives and Hedging (Prior authoritative literature: SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities", an amendment of FASB Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities") (ASC 815). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. Entities with instruments subject to ASC 815 must provide more robust qualitative disclosures and expanded quantitative disclosures. ASC 815 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of the applicable provisions of ASC 815 as of January 1, 2009, did not have a material impact on our consolidated results of operations or statement of financial position.

In November 2008, the FASB ratified ASC 323, which clarifies the accounting for certain transactions and impairment considerations involving equity method investments. ASC 323 is effective for fiscal years beginning after December 15, 2008. The adoption of the applicable provisions of ASC 323 as of January 1, 2009, did not have a material impact on our consolidated results of operations or statement of financial position or disclosures.

During May 2009, the FASB issued FASB ASC 855 Subsequent Events (Prior authoritative literature: SFAS No. 165, "Subsequent Events") (ASC 855), to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. ASC 855 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. This statement is effective for interim or annual financial periods ending after June 15, 2009. We adopted ASC 855 during our second fiscal quarter and it had no impact on results of operations or financial position. In the preparation of the condensed consolidated financial statements, we evaluated subsequent events after the balance sheet date of September 27, 2009 through November 6, 2009.

In June 2009, the FASB issued FASB ASC 810 Consolidation (Prior authoritative literature: SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)") (ASC 810) which changes the approach in determining the primary beneficiary of a variable interest entity (VIE) and requires companies to more frequently assess whether they must consolidate VIEs. ASC 810 is effective for annual periods beginning after November 15, 2009. We are evaluating the impact, if any, the adoption of ASC 810 will have on our consolidated financial statements.

In June 2009, the FASB issued FASB ASC 105 Generally Accepted Accounting Principles (Prior authoritative literature: SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162,") (ASC 105). ASC 105 establishes the FASB Accounting Standards Codification (Codification) as the source of authoritative U.S. GAAP for nongovernmental entities. The Codification, which does not change U.S. GAAP, takes the thousands of individual pronouncements that currently comprise U.S. GAAP and reorganizes them into approximately 90 accounting Topics, and displays all Topics using a consistent structure. Contents in each Topic are further organized first by Subtopic, then Section and finally Paragraph. The Paragraph level is the only level that contains substantive content. Citing particular content in the Codification involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure. FASB suggests that all citations begin with "FASB ASC," where ASC stands for Accounting Standards Codification. ASC 105 is effective for interim and annual periods ending after September 15, 2009 and will not have an impact on the Company's financial position but will change the referencing system for accounting standards.

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Risk Management

We are subject to various risks and uncertainties in the ordinary course of business due, in part, to the competitive global nature of the industry in which we operate, changing commodity prices for the materials used in the manufacture of our products, and the development of new products.

The functional currencies of our foreign operations in Mexico and Hungary are the Mexican peso and the euro, respectively. We have foreign operations in Mexico and Hungary that, due to the settlement of accounts receivable and accounts payable, require the transfer of funds denominated in their respective functional and legal currencies – the Mexican peso and the euro. The value of the Mexican peso increased by 2 percent in relation to the U.S. dollar in the first three quarters of 2009. The euro experienced an increase of 4 percent versus the U.S. dollar in the first three quarters of 2009. Foreign currency transaction gains in the third quarter of 2009 totaled $0.7 million compared to a gain of $1.2 million in the same period a year ago. For the first three quarters of 2009, we had foreign currency transaction losses totaling $1.0 million compared to a loss of $0.5 million in 2008. All transaction gains and losses are included in other income (expense) in the consolidated statement of operations.

As it relates to foreign currency translation gains and losses, however, since 1990, the Mexican peso has experienced periods of relative stability followed by periods of major declines in value. The impact of these changes in value relative to our Mexico operations has resulted in a cumulative unrealized translation loss at September 27, 2009 of $65.6 million. Since our initial investment in our joint venture in Hungary in 1995, the fluctuations in functional currencies have resulted in a cumulative unrealized translation gain at September 27, 2009 of $7.5 million. Translation gains and losses are included in other comprehensive income (loss) in the consolidated statements of shareholders' equity and comprehensive loss.

When market conditions warrant, we may also enter into contracts to purchase certain commodities used in the manufacture of our products, such as aluminum, natural gas and other raw materials in order to mitigate commodity price risk. Typically, any such commodity commitments are expected to be purchased and used over a reasonable period of time in the normal course of business. Accordingly, such normal purchase/normal sale (NPNS) commitments are not subject to the provisions of ASC 815, unless there is a change in the facts or circumstances in regard to the probability of taking full delivery of the contracted quantities.

We currently have several purchase agreements for the delivery of natural gas through 2012. With the recent closure of our manufacturing facility in Van Nuys, California in June 2009, and the completed closure in December 2008 of our manufacturing facility in Pittsburg, Kansas, we will no longer qualify for the NPNS exemption provided for under ASC 815 for the remaining natural gas purchase commitments related to those facilities. In addition, we have concluded that the natural gas purchase commitments for our manufacturing facility in Arkansas and certain natural gas commitments for our facilities in Chihuahua, Mexico no longer qualify for the NPNS exemption provided for under ASC 815 since we can no longer assert that it is probable we will take full delivery of these contracted quantities in light of the continued decline of our industry. In accordance with ASC 815 these natural gas purchase commitments are classified as being with "no hedging designation" and, accordingly, we are required to record any gains and/or losses associated with the changes in the estimated fair values of these commitments in our current earnings. The contract and fair values of these purchase commitments classified as "no hedging designation" at September 27, 2009 were $10.7 million and $6.9 million, respectively, which represents a gross liability of $3.8 million, of which $3.2 million was included in accrued expenses and the remaining $0.6 million was included in other non-current liabilities in our September 27, 2009 condensed consolidated balance sheet. The gains and losses on these commitments totaled a gain of $1.2 million in the third quarter of 2009 and a loss of $2.2 million for the first three quarters of 2009 which were included in cost of sales of our 2009 condensed consolidated statement of operations.

Based on the quarterly analysis of our estimated future production levels, certain natural gas purchase commitments with a contract value of $10.0 million and a fair value of $7.6 million for our manufacturing facilities in Mexico continue to qualify for the NPNS exemption provided for under ASC 815, since we can assert that it is probable we will take full delivery of the contracted quantities. The contract and fair values of all natural gas purchase commitments were $20.7 million and $14.5 million, respectively, at September 27, 2009. As of December 28, 2008, the aggregate contract and fair values of natural gas commitments were approximately $28.0 million and $21.1 million, respectively. Percentage changes in the market prices of natural gas will impact the fair values by a similar percentage. The recurring fair value measurement of the natural gas purchase commitments are based on quoted market prices using the market approach and the fair value is determined based on Level 1 inputs within the fair value hierarchy provided for under ASC 820.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Item 7A. Quantitative and Qualitative Disclosures About Market Risk in Part II of our 2008 Annual Report on Form 10-K and Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations – “Risk Management” in this Quarterly Report on Form 10-Q.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 27, 2009. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decision regarding required disclosures.

The evaluation of our disclosure controls and procedures included a review of their objectives and design, our implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, was being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis, and to maintain them as dynamic systems that change as conditions warrant.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 27, 2009, our disclosure controls and procedures were effective.

Inherent Limitations on Effectiveness of Controls

There are inherent limitations in the effectiveness of any control system, including the potential for human error and the circumvention or overriding of the controls and procedures. Additionally, judgments in decision-making can be faulty and breakdowns can occur because of simple error or mistake. An effective control system can provide only reasonable, not absolute, assurance that the control objectives of the system are adequately met. Accordingly, our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our control system can prevent or detect all error or fraud. Finally, projections of any evaluation or assessment of effectiveness of a control system to future periods are subject to the risks that, over time, controls may become inadequate because of changes in an entity’s operating environment or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control Over Financial Reporting

On October 2, 2009, Erika H. Turner, our Chief Financial Officer resigned, effective October 23, 2009, and Emil J. Fanelli, Vice President and Corporate Controller since 1997, was named acting Chief Financial Officer pending the recruitment of a permanent successor. Other than these changes, there were no changes in our internal control over financial reporting, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II
OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding reportable legal proceedings is contained in Item 3 - Legal Proceedings in Part I of our 2008 Annual Report on Form 10-K and in Note 16 – Commitments and Contingencies of this Quarterly Report on Form 10-Q.

On August 29, 2007, the plaintiffs filed an amended consolidated complaint that was substantially similar to the prior consolidated complaint in the matter In re Superior Industries International, Inc. Derivative Litigation. In response, we and the individual defendants filed motions to dismiss on September 21, 2007. In an order dated April 14, 2008, the court granted again our motion to dismiss the amended consolidated complaint. On May 5, 2008, the plaintiffs filed a verified second amended consolidated shareholder derivative complaint that alleges claims substantially similar to the prior complaints. Once again, the company and the individual defendants filed motions to dismiss on May 30, 2008. The court heard the motions to dismiss on September 15, 2008 but has yet to rule on the motions. On October 9, 2009, the parties entered into and filed with the court a stipulation of compromise and settlement which sets forth the terms and conditions of a proposed settlement of the consolidated shareholder derivative litigation. In connection with the proposed settlement, the company has agreed to adopt or maintain a variety of improved corporate governance measures, including practices and procedures for granting stock options and to release its officers, directors and employees from liability based on the matters alleged in the litigation. A hearing for preliminary approval of the proposed settlement is scheduled for November 9, 2009. We continue to anticipate that the resolution of this matter will not have a material adverse effect on our financial position or results of operations.

The South Coast Air Quality Management District (the SCAQMD) issued to us notices of violation (NOVs) on December 14, 2007 and in late 2008 and early 2009, alleging violations of certain permitting and air quality rules at our Van Nuys, California manufacturing facility. Throughout 2008 and 2009, we worked closely with the SCAQMD to achieve compliance and we took all steps necessary to remedy the issues associated with these violations. On September 22, 2009, we entered into a settlement agreement with the SCAQMD that required us to pay a civil penalty of $50,000 in exchange for a release from all liability with regard to any condition at the facility prior to June 30, 2009.

Other than the above, there were no material developments during the current quarter that require us to amend or update descriptions of legal proceedings previously reported in our 2008 Annual Report on Form 10-K.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Item 1A – Risk Factors in Part I of our 2008 Annual Report on Form 10-K, which could materially affect our business, financial condition or future results. The risks described in this report and in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may adversely affect our business, financial condition or future results. The following are the material changes to the risk factors contained in Item 1A – Risk Factors in our 2008 Annual Report on Form 10-K.

Current Economic and Financial Market Conditions; Financial Distress of OEM Customers - Current global economic and financial market conditions, including severe disruptions in the credit markets and the significant and potentially prolonged global economic recession, may materially and adversely affect our results of operations and financial condition. These conditions have and are likely to continue to materially impact the automotive industry generally and the financial stability of our customers, suppliers and other parties with whom we do business. Specifically, the impact of these volatile and negative conditions may include: decreased demand for our products due to the financial position of our OEM customers and general declines in the level of automobile demand; our decreased ability to accurately forecast future product trends and demand; and a negative impact on our ability to timely collect receivables from our customers and, conversely, reductions in the level and tightening of terms of trade credit available to us.

The foregoing economic and financial conditions, including decreased access to credit, may lead to increased levels of restructurings, bankruptcies, liquidations and other unfavorable events for our customers, suppliers and other service providers and financial institutions with whom we do business. Such events could, in turn, negatively affect our business either through loss of sales or inability to meet our commitments (or inability to meet them without excess expense) because of loss of suppliers or other providers.

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GM, Ford and Chrysler, who together represented approximately 81 percent of our total wheel sales for the first three quarters of 2009 and 82 percent for the 2008 fiscal year, are undergoing unprecedented financial distress. Globally, automakers are in financial distress, including additional OEMs who are our customers. Since late 2008, Chrysler and GM received emergency funding from the U.S. federal government as part of efforts to restructure both automakers. On April 30, 2009, Chrysler filed a voluntary petition under Chapter 11 of the U.S. Bankruptcy Code. This was followed on June 1, 2009 by GM's announcement that it was also filing a voluntary petition under Chapter 11 of the Bankruptcy Code. Reorganized entities for both Chrysler and GM emerged from bankruptcy on June 10, 2009 and July 10, 2009, respectively. Shortly after the Chapter 11 filings, both Chrysler and GM designated us as a key supplier, indicating that all pre-and post-petition accounts receivable would be paid in accordance with payment terms existing prior to the bankruptcy filings. There continues to be uncertainty surrounding the various restructurings within the automotive industry, which may lead to additional bankruptcy filings and additional financing from the U.S. government that may impose conditions on our customers that would adversely impact demand for our products.

Although both Chrysler and GM have subsequently emerged from bankruptcy, there can be no assurance that their respective bankruptcy restructurings will restore consumer confidence, increase vehicle production or improve the current economic and financial conditions. In addition, there continues to be uncertainty surrounding other restructurings within the automotive industry, which may lead to additional bankruptcy filings and additional financing from the U.S. government that may impose conditions on our customers that would adversely impact demand for our products.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no unregistered sales or repurchases of our common stock during the third quarter of 2009.

Item 6. Exhibits

3.1 Restated Articles of Incorporation of the Registrant (Incorporated by reference to Exhibit 3.1 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1994).

3.2 Amended and Restated By-Laws of the Registrant (Incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K filed September 5, 2007).

31.1 Certification of Steven J. Borick, Chairman, Chief Executive Officer and President, Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 (filed herewith).

31.2 Certification of Emil J. Fanelli, Chief Accounting Officer and acting Chief Financial Officer, Pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as Adopted Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 (filed herewith).

32.1 Certification of Steven J. Borick, Chairman, Chief Executive Officer and President, and Emil J. Fanelli, Chief Accounting Officer and acting Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

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SIGNATURES

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

SUPERIOR INDUSTRIES INTERNATIONAL, INC.
(Registrant)

Date: November 6, 2009	/s/ Steven J. Borick Steven J. Borick Chairman, Chief Executive Officer and President
Date: November 6, 2009	/s/ Emil J. Fanelli Emil J. Fanelli Chief Accounting Officer and acting Chief Financial Officer