

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

FORM 10-Q

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

For the quarterly period ended September 29, 2001

Commission file number 0-21835

SUN HYDRAULICS CORPORATION
(Exact Name of Registration as Specified in its Charter)

| | |
|--|--------------------------------------|
| FLORIDA | 59-2754337 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| 1500 WEST UNIVERSITY PARKWAY SARASOTA, FLORIDA | 34243 |
| (Address of Principal Executive Offices) | (Zip Code) |
| 941/362-1200 | |
| (Registrant's Telephone Number, Including Area Code) | |

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

The Registrant had 6,412,467 shares of common stock, par value \$.001, outstanding as of November 1, 2001.

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PART I: FINANCIAL INFORMATION
Item 1. Financial Statements**Sun Hydraulics Corporation**
Consolidated Balance Sheets
(in thousands)

| | September 29, 2001 | December 30, 2000 |
|---|--------------------|-------------------|
| | (unaudited) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,167 | \$ 2,698 |
| Accounts receivable, net of allowance for doubtful accounts of \$190 and \$163 | 5,858 | 6,112 |
| Inventories | 8,681 | 9,033 |
| Taxes receivable | 468 | — |
| Other current assets | 413 | 536 |
| | 19,587 | 18,379 |
| Property, plant and equipment, net | 43,743 | 44,984 |
| Other assets | 948 | 1,011 |
| | 64,278 | 64,374 |
| Total assets | \$ 64,278 | \$ 64,374 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,543 | \$ 1,787 |
| Accrued expenses and other liabilities | 2,051 | 1,585 |
| Long-term debt due within one year | 1,922 | 1,779 |
| Dividends payable | 256 | 255 |
| Taxes payable | — | 315 |
| | 5,772 | 5,721 |
| Long-term debt due after one year | 9,253 | 10,233 |
| Deferred income taxes | 4,103 | 4,106 |
| Other noncurrent liabilities | 440 | 478 |
| | 19,568 | 20,538 |
| Total liabilities | 19,568 | 20,538 |
| Shareholders' equity: | | |
| Preferred stock | — | — |
| Common stock | 6 | 6 |
| Capital in excess of par value | 24,486 | 24,486 |
| Retained earnings | 19,920 | 19,073 |
| Accumulated other comprehensive income | 298 | 271 |
| | 44,710 | 43,836 |
| Total liabilities and shareholders' equity | \$ 64,278 | \$ 64,374 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these financial statements.

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Sun Hydraulics Corporation
Consolidated Statements of Operations
(in thousands, except per share data)

| | Three months ended | |
|--|--------------------|--------------------|
| | September 29, 2001 | September 30, 2000 |
| | (unaudited) | (unaudited) |
| Net sales | \$ 15,119 | \$ 19,973 |
| Cost of sales | 11,849 | 14,465 |
| Gross profit | 3,270 | 5,508 |
| Selling, engineering and administrative expenses | 2,975 | 3,621 |
| Operating income | 295 | 1,887 |
| Interest expense | 218 | 293 |
| Miscellaneous expense (income) | (125) | 44 |
| Income before income taxes | 202 | 1,550 |
| Income tax provision | 51 | 528 |
| Net income | \$ 151 | \$ 1,022 |
| Basic net income per common share | \$ 0.02 | \$ 0.16 |
| Weighted average shares outstanding | 6,408 | 6,385 |
| Diluted net income per common share | \$ 0.02 | \$ 0.16 |
| Weighted average diluted shares outstanding | 6,564 | 6,540 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these financial statements.

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Sun Hydraulics Corporation
Consolidated Statements of Operations
(in thousands, except per share data)

| | Nine months ended | |
|--|--------------------|--------------------|
| | September 29, 2001 | September 30, 2000 |
| | (unaudited) | (unaudited) |
| Net sales | \$ 51,623 | \$ 61,938 |
| Cost of sales | 38,807 | 45,127 |
| Gross profit | 12,816 | 16,811 |
| Selling, engineering and administrative expenses | 9,807 | 10,831 |
| Operating income | 3,009 | 5,980 |
| Interest expense | 675 | 896 |
| Miscellaneous expense (income) | (74) | 184 |
| Income before income taxes | 2,408 | 4,900 |
| Income tax provision | 795 | 1,645 |
| Net income | \$ 1,613 | \$ 3,255 |
| Basic net income per common share | \$ 0.25 | \$ 0.51 |
| Weighted average shares outstanding | 6,392 | 6,385 |
| Diluted net income per common share | \$ 0.25 | \$ 0.50 |
| Weighted average diluted shares outstanding | 6,547 | 6,539 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these financial statements.

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Sun Hydraulics Corporation
Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income
(in thousands)

| | <u>Shares</u> | <u>Common stock</u> | <u>Capital in excess of par value</u> | <u>Retained earnings</u> | <u>Accumulated other comprehensive income</u> | <u>Total</u> |
|--|---------------|-------------------------|---|------------------------------|---|-----------------|
| Balance, December 30, 2000 | 6,385 | \$ 6 | \$24,486 | \$19,073 | \$ 271 | \$43,836 |
| Shares issued | 26 | | | | | |
| Dividends declared | | | | (766) | | (766) |
| Comprehensive income: | | | | | | |
| Net income | | | | 1,613 | | 1,613 |
| Foreign currency translation adjustments | | | | | 27 | 27 |
| Comprehensive income | | | | | | 1,640 |
| Balance, September 29, 2001 (unaudited) | <u>6,411</u> | <u>\$ 6</u> | <u>\$24,486</u> | <u>\$19,920</u> | <u>\$ 298</u> | <u>\$44,710</u> |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these financial statements.

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Consolidated Statements of Cash Flows
(in thousands)

| | Nine months ended | |
|---|--------------------|--------------------|
| | September 29, 2001 | September 30, 2000 |
| | (unaudited) | (unaudited) |
| Cash flows from operating activities: | | |
| Net income | \$ 1,613 | \$ 3,255 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,102 | 4,192 |
| (Gain)/Loss on disposal of assets | (15) | 275 |
| Provision for deferred income taxes | (3) | (24) |
| (Increase) decrease in: | | |
| Accounts receivable | 227 | (813) |
| Allowance for doubtful accounts | 27 | (40) |
| Inventories | 352 | (742) |
| Income tax receivable, net | (468) | 320 |
| Other current assets | 123 | 165 |
| Other assets | 21 | 3 |
| Increase (decrease) in: | | |
| Accounts payable | (244) | (707) |
| Accrued expenses and other liabilities | 466 | 826 |
| Income taxes payable, net | (315) | 283 |
| Other liabilities | (38) | 490 |
| Net cash provided by operating activities | 5,848 | 7,483 |
| Cash flows from investing activities: | | |
| Investment in acquisition and joint venture | — | (100) |
| Capital expenditures | (2,858) | (3,546) |
| Proceeds from dispositions of equipment | 55 | 102 |
| Net cash used in investing activities | (2,803) | (3,544) |
| Cash flows from financing activities: | | |
| Proceeds from debt | 571 | 2,999 |
| Repayment of debt | (1,408) | (4,973) |
| Dividends to shareholders | (766) | (766) |
| Net cash used in financing activities | (1,603) | (2,740) |
| Effect of exchange rate changes on cash and cash equivalents | 27 | (171) |
| Net increase in cash and cash equivalents | 1,469 | 1,028 |
| Cash and cash equivalents, beginning of period | 2,698 | 1,122 |
| Cash and cash equivalents, end of period | \$ 4,167 | \$ 2,150 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for: | | |
| Interest | \$ 675 | \$ 896 |
| Income taxes | \$ 1,581 | \$ 1,066 |

The accompanying Notes to the Consolidated Financial Statements are an integral part of these financial statements.

SUN HYDRAULICS CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(in thousands except per share data)

1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q. Accordingly, certain information and footnotes required by generally accepted accounting principles for complete financial statements are not included herein. The financial statements are prepared on a consistent basis (including normal recurring adjustments) and should be read in conjunction with the consolidated financial statements and related notes contained in the Annual Report on Form 10-K for the fiscal year ended December 30, 2000, filed by Sun Hydraulics Corporation (the "Company") with the Securities and Exchange Commission on March 12, 2001. In Management's opinion, all adjustments necessary for a fair presentation of the Company's financial statements are reflected in the interim periods presented.

2. NEW ACCOUNTING PRONOUNCEMENTS

On June 30, 2001, the Financial Accounting Standards Board finalized FAS 141, Business Combinations, and FAS 142, Goodwill and Other Intangible Assets. FAS 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting. With the adoption of FAS 142, effective January 1, 2002, goodwill is no longer subject to amortization. Rather, goodwill will be subject to at least an annual assessment for impairment by applying a fair-value-based test. Under the new rules, an acquired intangible asset should be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer's intent to do so. These intangible assets will be required to be amortized over their useful lives.

As of September 29, 2001, the Company had \$0.7 million of goodwill, net of accumulated amortization of \$0.1 million. Adoption of FAS 142 effective January 1, 2002 will result in the elimination of approximately \$60 of annual amortization, subject to the identification of separately recognized intangibles, which would continue to be amortized under the new rules. The Company has not yet determined the extent of impaired goodwill, if any, that will be recognized as of January 1, 2002.

In July 2001, the Financial Accounting Standards Board finalized FAS 143, Accounting for Asset Retirement Obligations, which requires the recognition of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the carrying amount of the related long-lived asset is correspondingly increased. Over time, the liability is accreted to its present value and the related capitalized charge is depreciated over the useful life of the asset. FAS 143 is effective for fiscal years beginning after June 15, 2002. The company is currently reviewing the impact that FAS 143 will have on its results.

In August 2001, the Financial Accounting Standards Board finalized FAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. FAS 144 addresses accounting and reporting for the impairment or disposal of long-lived assets, including the disposal of a segment of business. FAS 144 is effective for fiscal years beginning after December 15, 2001, with earlier application encouraged. We are currently reviewing the impact of SFAS 144 on the Company.

3. BUSINESS

Sun Hydraulics Corporation and its wholly-owned subsidiaries (the "Company") design, manufacture and sell screw-in cartridge valves and manifolds used in hydraulic systems. The Company has facilities in the United States, the United Kingdom, Germany, Korea, and China. Sun Hydraulics Corporation ("Sun Hydraulics"), with its main offices located in Sarasota, Florida, designs, manufactures and sells through independent distributors, primarily in the United States. Sun Hydraulik Holdings Limited ("Sun Holdings"), a wholly-owned subsidiary of Sun Hydraulics, was formed to provide a holding company for the European market operations; its wholly-owned subsidiaries are Sun Hydraulics Limited (a British corporation, "Sun

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Ltd.”) and Sun Hydraulik GmbH (a German corporation, “Sun GmbH”). Sun Ltd. operates a manufacturing and distribution facility located in Coventry, England, and Sun GmbH operates a manufacturing and distribution facility located in Erkelenz, Germany. Sun Hydraulics Korea Corporation (“Sun Korea”), a wholly-owned subsidiary of Sun Hydraulics, located in Incheon, South Korea, operates a manufacturing and distribution facility. Sun Hydraulics Systems (Shanghai) Co., Ltd. (“Sun China”), a 50/50 joint venture between Sun Hydraulics and Links Lin, the owner of Sun Hydraulics’ Taiwanese distributor, is located in Shanghai, China, and operates a manufacturing and distribution facility.

4. INVENTORY

| | <u>September 29, 2001</u> | <u>December 30, 2000</u> |
|-----------------|---------------------------|--------------------------|
| Raw materials | \$ 2,757 | \$ 3,300 |
| Work in process | 3,264 | 3,145 |
| Finished goods | 2,660 | 2,588 |
| Total | <u>\$ 8,681</u> | <u>\$ 9,033</u> |

5. LONG-TERM DEBT (in thousands)

| | <u>September 29, 2001</u> | <u>December 30, 2000</u> |
|--|---------------------------|--------------------------|
| \$5,677 four year, note, secured by U.S. equipment, interest at yield on four-year U. S. Treasury securities plus 1.75% (7.99% at September 29, 2001), due July 23, 2004 | \$ 4,205 | \$ 5,167 |
| \$6,187 10-year mortgage note with 15-year amortization schedule on the U.S. Manatee County facility, fixed interest rate of 7.375%, due July 1, 2006 | 4,453 | 4,575 |
| \$2,400 12-year mortgage note on the German facility, fixed interest rate of 6.05%, due September 30, 2008 | 1,151 | 1,118 |
| 10-year notes, fixed interest rates ranging from 3.5-5.1%, secured by equipment in Germany, due between 2009 and 2011 | 1,094 | 811 |
| Notes, fixed and variable interest ranging from 3-10.2%, secured by equipment in Korea | 206 | 240 |
| Other | 66 | 101 |
| | <u>11,175</u> | <u>12,012</u> |
| Less amounts due within one year | (1,922) | (1,779) |
| Total | <u>\$ 9,253</u> | <u>\$ 10,233</u> |

The Company has three revolving lines of credit totaling approximately \$9,400 with various banks. Interest rates on these credit facilities are variable based on the prime rate in the U.S. and the equivalent rate in the U.K. and Germany, respectively. All lines of credit expire in 2002. None of these arrangements contain pre-payment penalties. The total outstanding on these credit facilities was \$0 at both September 29, 2001 and December 30, 2000.

Certain of these debt instruments are subject to covenants including consolidated net working capital not less than \$2,000,000 and a current ratio not less than 1.2:1.0 at all times during the term of the loan.

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6. SEGMENT REPORTING

The individual subsidiaries comprising the Company operate predominantly in a single industry as manufacturers and distributors of hydraulic components. The subsidiaries are multinational with operations in the United States, the United Kingdom, Germany, and Korea. In computing operating profit for the foreign subsidiaries, no allocations of general corporate expenses have been made. Management bases its financial decisions by the geographical location of its operations.

Identifiable assets of the foreign subsidiaries are those assets related to the operation of those companies. United States assets consist of all other operating assets of the Company.

Segment information is as follows:

| | <u>United States</u> | <u>Korea</u> | <u>Germany</u> | <u>United Kingdom</u> | <u>Elimination</u> | <u>Consolidated</u> |
|--|----------------------|--------------|----------------|-----------------------|--------------------|---------------------|
| Three Months Ended September 29, 2001 | | | | | | |
| Sales to unaffiliated customers | \$10,156 | \$1,005 | \$1,406 | \$2,552 | \$ — | \$ 15,119 |
| Intercompany sales | 2,199 | — | 9 | 354 | (2,562) | — |
| Operating income | 11 | 6 | 2 | 247 | 29 | 295 |
| Depreciation and amortization | 1,026 | 45 | 74 | 165 | — | 1,310 |
| Capital expenditures | 558 | 10 | 26 | 658 | — | 1,252 |
| Three Months Ended September 30, 2000 | | | | | | |
| Sales to unaffiliated customers | \$13,614 | \$1,488 | \$1,566 | \$3,305 | \$ — | \$ 19,973 |
| Intercompany sales | 2,959 | — | 8 | 471 | (3,438) | — |
| Operating income | 1,156 | 112 | 96 | 568 | (45) | 1,887 |
| Depreciation and amortization | 1,068 | 44 | 70 | 222 | — | 1,404 |
| Capital expenditures | 619 | 24 | (395) | 116 | — | 364 |
| Nine Months Ended September 29, 2001 | | | | | | |
| Sales to unaffiliated customers | \$34,239 | \$3,421 | \$4,986 | \$8,977 | \$ — | \$ 51,623 |
| Intercompany sales | 8,531 | — | 27 | 1,228 | (9,786) | — |
| Operating income | 1,698 | 58 | 135 | 1,139 | (21) | 3,009 |
| Depreciation and amortization | 3,191 | 143 | 228 | 540 | — | 4,102 |
| Capital expenditures | 1,337 | 51 | 621 | 849 | — | 2,858 |
| Nine Months Ended September 30, 2000 | | | | | | |
| Sales to unaffiliated customers | \$43,032 | \$4,343 | \$4,658 | \$9,905 | \$ — | \$ 61,938 |
| Intercompany sales | 8,885 | — | 23 | 1,429 | (10,337) | — |
| Operating income | 4,090 | 277 | 275 | 1,418 | (80) | 5,980 |
| Depreciation and amortization | 3,214 | 117 | 201 | 660 | — | 4,192 |
| Capital expenditures | 2,559 | 430 | (156) | 713 | — | 3,546 |

Operating income is total sales and other operating revenue less operating expenses. Interest expense and net miscellaneous income (expense) have not been included in the computation of segment operating profit.

Included in U.S. sales to unaffiliated customers were export sales, principally to Canada and Asia, of \$4,509 and \$5,150 during the nine months ended September 29, 2001, and September 30, 2000, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Sun Hydraulics Corporation is a leading designer and manufacturer of high-performance screw-in hydraulic cartridge valves and manifolds, which control force, speed, and motion as integral components in fluid power systems. The Company sells its products globally, primarily through independent distributors. Approximately 66% of product sales are used by the mobile market, characterized by applications where the equipment is not fixed in place, the operating environment is often unpredictable, and duty cycles are generally moderate to low. The remaining 34% of sales are used by industrial markets, which are characterized by equipment that is fixed in place, typically in a controlled environment, with higher pressures and duty cycles. The Company sells to both markets with a single product line. In the first nine months of 2001, the Company generated 45% of its net sales outside of the United States.

Net income was \$0.2 million for the quarter ended September 29, 2001. This compares with net income of \$0.4 million last quarter and \$1.0 million for the quarter ended September 30, 2000. Net sales for the quarter ended September 29, 2001, were \$15.1 million, a decrease of 13.8% from last quarter and 24.9% from the same quarter last year. Basic and diluted earnings per share were \$0.02 for the third quarter of 2001, compared to \$0.16 for the same period last year.

Orders for the third quarter decreased 11% from the second quarter. While domestic orders declined only 5% from prior quarter, international orders declined 17%.

The 14% sales decrease from prior quarter was worse than anticipated, however, the profit exceeded expectations. Over the past two quarters controllable manufacturing costs have been reduced in proportion to the decreases in sales, and discretionary spending has been reduced where possible. Based on current order rates, net sales could be in the \$13 million range with a net loss of between \$0.5 to \$0.7 million. This would result in net income of \$0.9 to \$1.1 million for the year.

The Company's cash balance has increased \$1.5 million since the beginning of the year, while debt has been reduced \$0.8 million and dividends of \$0.8 million have been paid to shareholders. Management believes that the Company's cash flow and financing capability will enable it to remain financially strong even through a protracted economic downturn.

The Company continues to emphasize investments in product engineering, enhanced customer service, and marketing programs. The Company's experienced work force has been kept intact and no cost reductions have been made that will compromise performance in the long run or hinder the Company's ability to respond rapidly to an upturn in business.

COMPARISON OF THREE MONTHS ENDED SEPTEMBER 29, 2001 AND SEPTEMBER 30, 2000

Net sales decreased \$5.0 million, or 24.9%, to \$15.1 million for the quarter ended September 29, 2001, compared to the quarter ended September 30, 2000. This decrease was due to a continuing decline in the domestic market, which decreased \$3.3 million, or 28.0%, and softening in the international markets, which decreased \$1.7 million, or 20.6%. The decrease in international net sales was led by the United Kingdom business segment, which decreased \$0.8 million, or 23.4%, and Korea, which decreased \$0.5 million, or 32.4%.

Gross profit decreased \$2.2 million, or 40.6%, to \$3.3 million for the quarter ended September 29, 2001, compared to the quarter ended September 30, 2000. Gross profit as a percentage of net sales decreased to 21.6%, compared to 27.6% for the third quarter of 2000. The 6.0% decrease in gross profit as a percent of net sales was primarily due to the decrease in net sales.

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Selling, engineering and administrative expenses decreased 17.8%, or \$0.6 million, to \$3.0 million in the quarter ended September 29, 2001, compared to \$3.6 million in the quarter ended September 30, 2000. This decrease is due to lower spending in many discretionary expense categories in the United States operations.

Interest expense was \$0.2 million for the quarter ended September 29, 2001, compared to \$0.3 million for the quarter ended September 30, 2000. This decrease was due to a reduction in total debt from \$12.4 million to \$11.2 million, or \$1.2 million.

Other income was \$0.1 million for the quarter ended September 29, 2001. Other income for the third quarter of 2001 consisted mainly of foreign currency gains in the United Kingdom and Germany.

The provision for income taxes for the quarter ended September 29, 2001, was 29.3% of pretax income, compared to 34.1% of pretax income for the quarter ended September 30, 2000. The decrease was due to a change in the level of income in each country where different tax rates are in effect. In both years, tax savings were realized in the United States from the Sun Hydraulics Foreign Sales Corporation.

COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 29, 2001 AND SEPTEMBER 30, 2000

Net sales decreased \$10.8 million, or 17.3%, to \$51.6 million for the nine months ended September 29, 2001, compared to the nine months ended September 30, 2000. Domestic net sales decreased \$9.4 million due primarily to the general slowdown in the manufacturing sector of the North American economy. International net sales decreased \$1.4 million with Korea down \$0.9 million, or 21.2%.

Gross profit decreased \$4.0 million, or 23.8%, to \$12.8 million for the nine months ended September 29, 2001, compared to the nine months ended September 30, 2000. Gross profit as a percentage of net sales decreased to 24.8% for the nine months ended September 29, 2001, compared to 27.1% for the nine months ended September 30, 2000. The decrease in gross profit as a percent of net sales was primarily due to the decrease net sales.

Selling, engineering and administrative expenses decreased \$1.0 million, or 9.5%, to \$9.8 million for the nine months ended September 29, 2001, compared to \$10.8 million for the nine months ended September 30, 2000. This decrease is due to lower spending in many discretionary expense categories in the United States operations offset by moderate increases in the foreign operations.

Interest expense was \$0.7 million for the nine months ended September 29, 2001, compared to \$0.9 million for the nine months ended September 30, 2000. This decrease was due to a reduction in total debt from \$13.4 million to \$11.6 million, or \$1.8 million.

Other income was \$0.1 million for the nine months ended September 29, 2001, compared to other expense of \$0.2 million for the nine months ended September 30, 2000. The difference of \$0.3 million consists of other income in 2001 from foreign currency gains and interest income in the UK, offset by other expenses in 2000, primarily the disposal of certain equipment no longer used in production in the United States and United Kingdom operations.

The provision for income taxes for the quarter ended September 29, 2001, was 33.0% of pretax income, compared to 33.6% of pretax income for the quarter ended September 30, 2000. The decrease is due to a change in the level of income in each country where different tax rates are in effect. In both years, tax savings were realized in the United States from the Sun Hydraulics Foreign Sales Corporation.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company's primary source of capital has been cash generated from operations, although fluctuations in working capital requirements have been met through borrowings under revolving lines of credit. The Company's principal uses of cash have been to pay operating expenses, make capital expenditures, pay dividends to shareholders, and service debt.

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Cash from operations for the nine months ended September 29, 2001, was \$5.8 million. This compares with \$7.5 million for the nine months ended September 30, 2000. The \$1.7 million decrease was primarily due to a \$1.7 million decrease in net income. Days sales outstanding (DSO) was 35 and 32 at September 29, 2001, and September 30, 2000, respectively. DSO was up in the third quarter of 2001 due to a smaller percentage of total sales being generated in the United States where the DSO is typically the lowest. Inventory turns were 5.5 and 6.5 at September 29, 2001, and September 30, 2000, respectively. Inventory turns were down across all business segments.

Capital expenditures, consisting primarily of purchases of machinery and equipment, were \$2.9 million for the nine months ended September 29, 2001, compared to \$3.5 million for the quarter ended September 30, 2000.

The Company believes that cash generated from operations and its borrowing availability under its revolving lines of credit will be sufficient to satisfy the Company's operating expenses and capital expenditures for the foreseeable future.

The Company declared a quarterly dividend of \$0.04 per share to shareholders of record on September 30, 2001, which was paid on October 15, 2001.

SEASONALITY AND INFLATION

The Company generally has experienced reduced activity during the fourth quarter of the year, largely as a result of fewer working days due to holiday shutdowns. The Company does not believe that inflation had a material effect on its operations for the periods ended September 29, 2001, and September 30, 2000. There can be no assurance, however, that the Company's business will not be affected by inflation in the future.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in interest rates on borrowed funds, which could affect its results of operations and financial condition. At September 29, 2001, the Company had approximately \$4.2 million in variable-rate debt outstanding and, as such, the market risk is immaterial based upon a 10% increase or decrease in interest rates. The Company manages this risk by selecting debt financing that is based on the prime rate or Treasury securities rate in the U.S., or the equivalent rate in the U.K., Germany, and Korea, respectively.

FORWARD-LOOKING INFORMATION

Certain oral statements made by management from time to time and certain statements contained herein that are not historical facts are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934 and, because such statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Forward-looking statements, including those in Management’s Discussion and Analysis of Financial Condition and Results of Operations are statements regarding the intent, belief or current expectations, estimates or projections of the Company, its Directors or its Officers about the Company and the industry in which it operates, and assumptions made by management, and include among other items, (i) the Company’s strategies regarding growth, including its intention to develop new products; (ii) the Company’s financing plans; (iii) trends affecting the Company’s financial condition or results of operations; (iv) the Company’s ability to continue to control costs and to meet its liquidity and other financing needs; (v) the declaration and payment of dividends; and (vi) the Company’s ability to respond to changes in customer demand domestically and internationally, including as a result of standardization. Although the Company believes that its expectations are based on reasonable assumptions, it can give no assurance that the anticipated results will occur.

Important factors that could cause the actual results to differ materially from those in the forward-looking statements include, among other items, (i) the economic cyclicality of the capital goods industry in general and the hydraulic valve and manifold industry in particular, which directly affect customer orders, lead times and sales volume; (ii) conditions in the capital markets, including the interest rate environment and the availability of capital; (iii) changes in the competitive marketplace that could affect the Company’s revenue and/or cost bases, such as increased competition, lack of qualified engineering, marketing, management or other personnel, and increased labor and raw materials costs; (iv) changes in technology or customer requirements, such as standardization of the cavity into which screw-in cartridge valves must fit, which could render the Company’s products or technologies noncompetitive or obsolete; (v) new product introductions, product sales mix and the geographic mix of sales nationally and internationally; and (vi) changes relating to the Company’s international sales, including changes in regulatory requirements or tariffs, trade or currency restrictions, fluctuations in exchange rates, and tax and collection issues. Further information relating to factors that could cause actual results to differ from those anticipated is included but not limited to information under the headings “Business” (including under the subheading “Business Risk Factors”) in the Company’s Form 10-K for the year ended December 30, 2000, and “Management’s Discussion and Analysis of Financial Conditions and Results of Operations” in this Form 10-Q for the quarter ended September 29, 2001. The Company disclaims any intention or obligation to update or revise forward-looking statements, whether as a result of new information, future events or otherwise.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings.

None.

Item 2. Changes in Securities.

None.

Item 3. Defaults upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K

None.

(a) Exhibits:

| Exhibit Number | Exhibit Description |
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| 3.1 | Amended and Restated Articles of Incorporation of the Company (previously filed as Exhibit 3.1 in the Pre-Effective Amendment No. 4 to the Company's Registration Statement on Form S-1 filed on December 19, 1996 (File No. 333-14183) and incorporated herein by reference). |
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| 4.5 | Mortgage and Security Agreement, dated January 9, 1992, between Suninco, Inc., Sun Hydraulics Corporation, and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.5 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference). |
| 4.6 | Loan Agreement, dated March 29, 1996, between Suninco, Inc., Sun Hydraulics Corporation, and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.6 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference). |
| 4.7 | Security Agreement, dated March 29, 1996, between Suninco, Inc., Sun Hydraulics Corporation, and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.7 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference). |
| 4.8 | Modification and Additional Advance Agreement, dated March 29, 1996, between Suninco, Inc. and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.8 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference). |

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- 4.9 Consolidated Note, dated March 29, 1996, in the amount of \$2,475,000.00, given by Suninco, Inc. to Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.9 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).
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- 4.15 Security Agreement, dated June 14, 1996, between Sun Hydraulics Corporation and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.15 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).
- 4.16 Promissory Note, dated June 14, 1996, in the amount of \$6,187,000.00, given by Sun Hydraulics Corporation and Suninco, Inc. to Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.16 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).
- 4.17 Revolving Loan Facility letter agreement, dated July 30, 1996, in the amount of £800,000, between Sun Hydraulics Ltd. and Lloyds Bank Plc. (previously filed as Exhibit 4.17 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).
- 4.18 Overdraft and Other Facilities letter agreement, dated June 7, 1996, in an amount not to exceed £250,000, between Sun Hydraulics Ltd. and Lloyds Bank Plc. (previously filed as Exhibit 4.18 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).

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- 4.19 Mortgage, dated April 11, 1996, between Sun Hydraulik GmbH and Dresdner Bank (previously filed as Exhibit 4.19 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).
- 4.21 Master Note, dated February 3, 1997, in the amount of \$10,000,000.00, made by the Company to evidence a line of credit granted to the Company by Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996 and incorporated herein by reference).
- 4.22 Renewal Master Note, dated February 3, 1998, in the amount of \$10,000,000.00, made by the Company to evidence a line of credit granted to the Company by Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.22 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and incorporated herein by reference).
- 4.23 Modification Agreement, dated March 1, 1998, between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.23 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and incorporated herein by reference).
- 4.24 Renewal Master Note, dated as of February 3, 1998, in the amount of \$4,965,524.51, between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.24 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998 and incorporated herein by reference).
- 4.25 Renewal Master Note, dated of February 3, 1999, in the amount of \$4,965,524.51, between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.25 to the Company's Quarterly Report on Form 10-Q for the quarter ended April 3, 1999 and incorporated herein by reference).
- 4.26 Renewal Master Note, dated July 23, 1999, in the amount of \$5,000,000.00 between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.26 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 3, 1999 and incorporated herein by reference).
- 4.27 Loan Agreement, dated July 23, 1999, in the amount of \$7,500,000.00, between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.27 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 3, 1999 and incorporated herein by reference).
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- 4.29 Promissory Note, dated July 23, 1999, in the amount of \$7,500,000.00, between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.29 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 3, 1999 and incorporated herein by reference).
- 4.30 Loan Agreement, dated July 23, 2000, by and among Northern Trust Bank of Florida, N.A. as Lender, Sun Hydraulics Corporation as Borrower, and Sun Hydraulik Holdings Limited, Sun Hydraulics Limited and Sun Hydraulik GmbH as Guarantors (previously filed as Exhibit 4.30 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 and incorporated herein by reference).

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| 4.31 | First Amendment to Security Agreement, dated July 23, 2000, by and among Northern Trust Bank of Florida, N.A. and Sun Hydraulics Corporation. (previously filed as Exhibit 4.31 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 and incorporated herein by reference). |
| 4.32 | Master Note, dated July 23, 2000, in the amount of \$7,500,000.00, made by Sun Hydraulics Corporation in favor of Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.32 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 and incorporated herein by reference). |
| 4.33 | Amended and restated Loan Agreement by and among Northern Trust Bank of Florida, N.A., Sun Hydraulics Corporation, Sun Hydraulik Holdings Limited, Sun Hydraulics Limited and Sun Hydraulik GmbH dated November 1, 2000 (previously filed as Exhibit 4.33 to the Company's Annual Report on Form 10-K for the year ended December 30, 2000 and incorporated herein by reference.). |
| 10.1 | Form of Distributor Agreement (Domestic) (previously filed as Exhibit 10.1 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference). |
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| 10.4+ | Amendment No. 1 to 1996 Stock Option Plan (previously filed as Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997 and incorporated herein by reference). |
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| 10.8+ | Sun Hydraulics Corporation Employee Stock Purchase Plan (previously filed as Exhibit 4 to the Company's registration statement on Form S-8 filed on July 27, 2001 (file No. 333-66008), and incorporated herein by reference.) |

+ Executive management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K.

Report on Form 8-K (dated August 23, 2001) filed August 24, 2001, announcing quarterly dividend.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Sarasota, State of Florida on November 7, 2001.

SUN HYDRAULICS CORPORATION

By: /s/ Richard J. Dobbyn

Richard J. Dobbyn

Chief Financial Officer (Principal
Financial and Accounting Officer)

EXHIBIT INDEX

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