

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 July 1, 2000 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 [X] No [ ]

The Registrant had 6,384,948 shares of common stock, par value \$.001, outstanding as of August 3, 2000.

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For the second quarter ended July 1, 2000

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PART I: FINANCIAL INFORMATION

Item 1.

SUN HYDRAULICS CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS)

<TABLE>  
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	JULY 1, 2000	JANUARY 1, 2000
	-----	-----
	(UNAUDITED)	
	<C>	<C>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,517	\$ 1,122
Accounts receivable, net of allowance for doubtful accounts of \$156 and \$196		8,196 6,260
Inventories	8,318	8,131
Taxes receivable	0	455
Other current assets	597	591
	-----	-----
Total current assets	18,628	16,559
Property, plant and equipment, net	46,585	46,529

Other assets	1,075	986
	-----	-----
Total assets	<u>\$66,288</u>	<u>\$64,074</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,617	\$ 2,712
Accrued expenses and other liabilities	2,466	1,464
Long-term debt due within one year	2,117	3,033
Notes payable to related parties due within one year	219	378
Dividends payable	255	255
Taxes payable	594	--
	-----	-----
Total current liabilities	8,268	7,842
Long-term debt due after one year	10,953	10,830
Notes payable to related parties due after one year	78	101
Deferred income taxes	4,110	4,125
Other noncurrent liabilities	195	--
	-----	-----
Total liabilities	23,604	22,898
Commitments and contingencies		
Shareholders' equity:		
Preferred stock	--	--
Common stock	6	6
Capital in excess of par value	24,486	24,486
Retained earnings	17,896	16,173
Accumulated other comprehensive income		296
	-----	-----
Total shareholders' equity	42,684	41,176
	-----	-----
Total liabilities and shareholders' equity	<u>\$66,288</u>	<u>\$64,074</u>

</TABLE>

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

SUN HYDRAULICS CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	THREE MONTHS ENDED	
	JULY 1,	JULY 3,
	2000	1999
	-----	-----
	(UNAUDITED)	
NET SALES	\$21,896	\$ 15,921
Cost of sales	15,698	12,982
	-----	-----
GROSS PROFIT	6,198	2,939
Selling, engineering and		

administrative expenses	3,544	3,068	
	-----	-----	
OPERATING INCOME (LOSS)		2,654	(129)
Interest expense	313	176	
Miscellaneous expense (income)		193	36
	-----	-----	
INCOME (LOSS) BEFORE INCOME TAXES		2,148	(341)
Income tax provision	771	(125)	
	-----	-----	
NET INCOME (LOSS)	\$ 1,377	\$ (216)	
	=====	=====	
BASIC NET INCOME PER COMMON SHARE		\$ 0.22	\$ (0.03)
WEIGHTED AVERAGE SHARES OUTSTANDING		6,385	6,383
DILUTED NET INCOME PER COMMON SHARE		\$ 0.21	\$ (0.03)
WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING		6,541	6,383

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)

	SIX MONTHS ENDED	
	JULY 1, 2000	JULY 3, 1999
	-----	-----
	(UNAUDITED)	
NET SALES	\$41,966	\$34,386
Cost of sales	30,664	26,927
	-----	-----
GROSS PROFIT	11,302	7,459
Selling, engineering and administrative expenses	7,210	6,160
	-----	-----
OPERATING INCOME	4,092	1,299
Interest expense	603	429
Miscellaneous (income) expense	140	133
	-----	-----
INCOME BEFORE INCOME TAXES	3,349	737
Income tax provision	1,116	230
	-----	-----
NET INCOME	\$ 2,233	\$ 507
	=====	=====
BASIC NET INCOME PER COMMON SHARE	\$ 0.35	\$ 0.08

WEIGHTED AVERAGE SHARES OUTSTANDING	6,385	6,375
DILUTED NET INCOME PER COMMON SHARE	\$ 0.34	\$ 0.08
WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING	6,532	6,528

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)

<TABLE>  
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	CAPITAL IN		ACCUMULATED OTHER		COMPREHENSIVE	TOTAL	
	SHARES	COMMON STOCK	EXCESS OF PAR VALUE	RETAINED EARNINGS	INCOME		
<S>	<C>	<C>	<C>	<C>	<C>		
Balance, December 31, 1997		6,322	6	24,163	10,732	99	35,000
Dividends declared				(1,016)		(1,016)	
Exercise of stock options		39		223		223	
Comprehensive income:							
Net income				5,647		5,647	
Foreign currency translation adjustments					161	161	
Comprehensive income						5,808	
Balance, December 31, 1998		6,361	6	24,386	15,363	260	40,015
Dividends declared				(1,021)		(1,021)	
Exercise of stock options		22		75		75	
Issue of stock		2	13		13		
Tax effect of non-qualified stock options				12		12	
Comprehensive income:							
Net income				1,831		1,831	
Foreign currency translation adjustments					251	251	
Comprehensive income						2,082	
Balance, January 1, 2000		6,385	6	24,486	16,173	511	41,176
Dividends declared				(510)		(510)	
Comprehensive income:							
Net income				2,233		2,233	
Foreign currency translation adjustments					(215)	(215)	
Comprehensive income						2,018	
Balance, July 1, 2000 (unaudited)		6,385	\$ 6	\$24,486	\$17,896	\$296	\$42,684

</TABLE>

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 CASH FLOWS  
(IN THOUSANDS)

<TABLE>  
<CAPTION>

	SIX MONTHS ENDED	
	JULY 1, 2000	JULY 3, 1999
	-----	-----
	(UNAUDITED)	
<S>	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 2,233	\$ 507
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,788	2,440
(Gain)/Loss on disposal of assets	328	127
Provision for deferred income taxes	(15)	(20)
(Increase) decrease in:		
Accounts receivable	(1,896)	(542)
Allowance for doubtful accounts	(40)	(93)
Inventories	(187)	758
Income tax receivable, net	455	--
Other current assets	(6)	(24)
Other assets	(18)	51
Increase (decrease) in:		
Accounts payable	(95)	(870)
Accrued expenses and other liabilities	1,003	(395)
Income taxes payable, net	594	104
Other liabilities	195	--
	-----	-----
Net cash provided by operating activities	5,339	2,043
	-----	-----
Cash flows from investing activities:		
Investment in acquisition and joint venture	(100)	(100)
Capital expenditures	(3,183)	(3,135)
Proceeds from dispositions of equipment	40	43
	-----	-----
Net cash used in investing activities	(3,243)	(3,192)
	-----	-----
Cash flows from financing activities:		
Proceeds from debt	2,910	5,128
Repayment of debt	(3,703)	(3,850)
Repayment of notes payable to related parties	(182)	(494)
Proceeds from exercise of stock options	--	75
Dividends to shareholders	(511)	(510)
	-----	-----
Net cash provided by (used in) financing activities	(1,486)	349
	-----	-----
Effect of exchange rate changes on cash and cash equivalents		
	(215)	52
	-----	-----
Net increase (decrease) in cash and cash equivalents	395	(748)
Cash and cash equivalents, beginning of period	1,122	1,592
	-----	-----
Cash and cash equivalents, end of period	\$ 1,517	\$ 844
	=====	=====

Supplemental disclosure of cash flow information:

Cash paid for:			
Interest (including amounts capitalized)	\$ 603		\$ 484
	=====	=====	
Income taxes	\$ 82	\$ 146	
	=====	=====	
Non-cash tax effect of non-qualified stock options	\$ --		\$ 12
	=====	=====	

</TABLE>

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

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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 January 1, 2000, filed by Sun Hydraulics Corporation (the "Company") with the Securities and Exchange Commission on March 8, 2000.

2. 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, and Korea. Sun Hydraulics Corporation ("Sun Hydraulics"), with its main offices located in Sarasota, Florida, designs, manufactures and sells primarily through independent distributors. Sun Hydraulik Holdings Limited ("Sun Holdings"), a wholly-owned subsidiary of Sun Hydraulics, was formed to provide a holding company vehicle for the European market operations; its wholly-owned subsidiaries are Sun Hydraulics Limited (a British corporation, "Sun 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, located in Erkelenz, Germany, designs, manufactures and markets the Company's products in German-speaking European markets. Sun Hydraulics Korea Corporation ("Sun Korea"), a wholly-owned subsidiary of Sun Hydraulics, located in Inchon, Korea, operates a manufacturing and distribution facility.

3. JOINT VENTURE

On November 1, 1998, Sun Hydraulics entered into a 50/50 joint venture agreement ("joint venture") with Links Lin, the owner of Sun Hydraulics Corporation's Taiwanese distributor. This agreement provides for an initial capital contribution of \$250, which is recorded in Investment in joint venture in the Company's financial statements on Form 10-K. An additional investment of \$100 was made on March 15, 2000.

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4. LONG-TERM DEBT (in thousands)

	July 1,	January 1,
	2000	2000
	-----	-----
	(unaudited)	

Lines of credit agreements-unsecured	\$ 500	\$ 2,215
Lines of credit agreements-secured	5,677	4,616
Mortgage note payable-U.S. Manatee County facility	4,650	4,725
Mortgage note payable-German facility	1,204	1,352
Secured notes payable-German equipment	898	933
Secured notes payable-Korea	141	22
	-----	-----
	13,070	13,863
Less amounts due within one year	(2,117)	(3,033)
	-----	-----
	\$ 10,953	\$ 10,830
	=====	=====

The Company has four revolving lines of credit: two in the United States, one in England, and one in Germany. None of these arrangements contain pre-payment penalties.

On July 23, 1999, the Company replaced its \$10,000 unsecured revolving credit facility with a five year, secured, revolving credit facility of \$7,500, and a one-year unsecured, revolving credit facility of \$5,000. The \$7,500 credit facility has an interest rate equal to the bank lender's prime rate less 1% for the first year, and the Treasury bill rate plus 1.75% for the remaining four years. The \$5,000 credit facility has an interest rate equal to the bank lender's prime rate less 1% or LIBOR plus 1.9% for predetermined periods of time, at the Company's option. At July 1, 2000, the interest rate for both the secured and unsecured facilities was 8.5%, and the balances outstanding were \$5,677 and \$500, respectively. Both credit facilities are subject to certain debt covenants.

A 10-year mortgage loan of \$6,200 was obtained, at a fixed interest rate of 8.25%, for construction of the Manatee County facility. Terms on the construction note were interest-only on the balance drawn down through the completion of construction and then conversion to a 10-year mortgage note with a 15-year amortization schedule. In April 1999, this mortgage note was renegotiated to an interest rate of 7.375%. Terms are monthly principal and interest payments with remaining principal due July 1, 2006. At July 1, 2000, \$4,650 was outstanding under this mortgage loan.

In May 1996, the Company obtained a mortgage loan of approximately \$2,400, denominated in German marks, for the facility in Erkelenz, Germany. The loan has a term of 12 years and bears interest at 6.47%. At July 1, 2000, the outstanding balance of this mortgage note was \$1,204.

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In February 1999, the Company negotiated three loans in Germany, secured by equipment: a ten year 5.1% fixed interest rate loan for approximately \$300, a ten year 5.1% fixed interest rate loan for approximately \$100, and a ten year 3.5% fixed interest rate loan for approximately \$800. At July 1, 2000, the outstanding balances on these facilities were \$212, \$0, and \$657, respectively.

In April 2000, the Company obtained a loan in Korea for approximately \$107, secured by equipment. The loan has a variable interest rate of between 3% and 5%; the current rate on the loan is 4%. Terms are monthly interest payments only through April 2003, and monthly principal and interest payments from May 2003 through April 2006.

## 5. SEGMENT REPORTING

The Company has adopted Statement of Accounting Standards No. 131, "Disclosures about Segments of Enterprise and Related Information" ("SFAS 131"). This approach designates the internal organization that is used by management for making operational decisions and addressing performance as the



source of determining the Company's reportable segments. Management bases its financial decisions by the geographical location of its operations.

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.

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:

<TABLE>  
<CAPTION>

	United States	Korea	United Kingdom	Germany	Elimination	Consolidated
<S>	<C>	<C>	<C>	<C>	<C>	<C>
THREE MONTHS ENDED JULY 1, 2000						
Sales to unaffiliated customers	\$ 15,695	\$1,408	\$3,233	\$1,560	\$ --	\$ 21,896
Intercompany sales	3,101	--	431	7	(3,539)	--
Operating profit	1,994	26	443	123	68	2,654
Depreciation and amortization	1,097	40	205	68	--	1,410
Capital expenditures	828	237	535	155	--	1,755
THREE MONTHS ENDED JULY 3, 1999						
Sales to unaffiliated customers	\$ 10,691	\$1,152	\$2,803	\$1,275	\$ --	\$ 15,921
Intercompany sales	2,139	--	483	7	(2,629)	--
Operating profit	(410)	9	215	40	17	(129)
Depreciation expense	944	19	203	75	--	1,241
Capital expenditures	1,575	63	101	42	--	1,781

</TABLE>

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<TABLE>  
<S>

	<C>	<C>	<C>	<C>	<C>	<C>
SIX MONTHS ENDED JULY 1, 2000						
Sales to unaffiliated customers	\$ 29,418	\$2,856	\$6,599	\$3,093	\$ --	\$ 41,966
Intercompany sales	5,926	--	958	15	(6,899)	--
Operating profit	2,934	165	850	178	(35)	4,092
Identifiable assets	50,172	1,358	8,911	6,271	(424)	66,288
Depreciation and amortization	2,146	73	438	131	--	2,788
Capital expenditures	1,941	406	597	239	--	3,183
SIX MONTHS ENDED JULY 3, 1999						
Sales to unaffiliated customers	\$ 24,233	\$1,874	\$5,587	\$2,692	\$ --	\$ 34,386
Intercompany sales	3,837	--	1,081	14	(4,932)	--
Operating profit	308	37	668	183	103	1,299
Identifiable assets	45,529	742	8,422	6,297	(244)	60,746
Depreciation expense	1,860	19	404	157	--	2,440
Capital expenditures	2,191	46	556	342	--	3,135

</TABLE>

Operating profit is total sales and other operating income less operating expenses. In computing segment operating profit, interest expense and net miscellaneous income (expense) have not been deducted (added).

Included in U.S. sales to unaffiliated customers were export sales, principally to Canada and Asia, of \$3,471 and \$2,824 during the six months ended July 1, 2000, and July 3, 1999, respectively.

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Item 2.

## 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 1999, the Company generated approximately 37% of its net sales outside of the United States.

Orders for the three months ended July 1, 2000, increased \$4.8 million, or 30.7%, to \$20.3 million compared to the three months ended July 3, 1999. Orders for the six months ended July 1, 2000, increased \$9.1 million, or 27.5%, to \$42.0 million compared to the six months ended July 3, 1999. The exceptionally strong demand in the first half of the year has not continued. Orders for the three months ended July 1, 2000, decreased \$1.4 million or 6.5% compared to the previous quarter. Management believes at the current incoming order rate, third quarter shipments will be lower than in the second quarter.

The United States National Fluid Power Association reported an 11.0% overall increase in orders for hydraulic products for the first five months of 2000 over the same period a year ago. This increase includes an 11.3% increase in mobile hydraulic orders and a 12.5% increase in industrial hydraulic orders.

The Company's net sales increased 37.5% for the three months ended July 1, 2000, compared to the three months ended July 3, 1999. Net sales in the three months ended July 1, 2000 increased \$1.8 million, or 9.1%, to \$21.9 million compared to the previous quarter. Net income increased 60.7% to \$1.4 million for the three months ended July 1, 2000, compared to the previous quarter. The \$1.8 million increase in sales and the \$1.4 million increase in net income were primarily due to improved production rates and productivity in the United States manufacturing operations. Management believes these improvements are the result of the high level of production workload created by the strong first quarter demand, the recently completed capacity expansion program, new manufacturing systems, and quality of supplier parts.

### COMPARISON OF THREE MONTHS ENDED JULY 1, 2000 AND JULY 3, 1999

Net sales increased \$6.0 million, or 37.5%, to \$21.9 million for the quarter ended July 1, 2000, compared to the quarter ended July 3, 1999. This increase was due to an increase in demand across all business segments and improved manufacturing productivity in the United States operations. Also, net sales in the quarter ended July 3, 1999, were adversely affected by reduced production output in the United States operations related to problems with a new manufacturing system implementation.

Gross profit increased \$3.3 million, or 110.9%, to \$6.2 million for the quarter ended July 1, 2000, compared to the quarter ended July 3, 1999. Gross profit as a percentage of net sales increased to 28.3% compared to 18.5% for the second quarter of 1999. This percentage increase was due to substantially higher total net sales in the quarter ended July 1, 2000, and an unusually low gross profit percentage in the quarter ended July 3, 1999, related to problems implementing a new manufacturing system in the United States operations. Also, in the quarter ended July 1, 2000, prime manufacturing costs in the United States operations were lower as a percentage of net sales than the quarter ended July 3, 1999, primarily due to reduced costs of purchased parts. Manufacturing overhead expenses in the United States increased in the quarter ended July 1, 2000, over the same period last year due mainly to higher depreciation expense.

Selling, engineering and administrative expenses increased 15.5%, or \$0.5 million, to \$3.6 million in the quarter ended July 1, 2000, compared to \$3.1 million in the quarter ended July 3, 1999. This increase was due primarily to increased spending levels for product catalogues and for support and enhancements to new software systems in the United States and the United Kingdom operations.

Interest expense was \$0.3 million for the quarter ended July 1, 2000, compared to \$0.2 million for the quarter ended July 3, 1999. This increase was due to an increase in total debt of \$1.0 million, and increased interest rates on both lines of credit in the United States, which vary in relation to the United States prime rate.

Other expense of \$0.2 million for the quarter ended July 1, 2000, consisted primarily of the disposal of certain equipment no longer used in production in the United States and United Kingdom operations partially offset by exchange rate gains.

The provision for income taxes for the quarter ended July 1, 2000, was 35.9% of pretax income, compared to 36.5% of pretax loss for the quarter ended July 3, 1999. Tax savings were realized in the United States from the Sun Hydraulics Foreign Sales Corporation. The Company had previously recorded its provision for income taxes believing an income tax benefit had been obtained for the Korean operation; the tax benefit request was recently denied by the Korean government. Although, the Company plans to resubmit an application for this benefit, management is unsure of the outcome. A retroactive, immaterial adjustment has been recorded in the quarter ended July 1, 2000, to increase the provision for income taxes.

Net income for the three months ended July 1, 2000, was \$1.4 million, compared to a net loss of \$0.2 million for the three months ended July 3, 1999.

#### COMPARISON OF SIX MONTHS ENDED JULY 1, 2000 AND JULY 3, 1999

Net sales increased \$7.6 million, or 22.0%, to \$42.0 million for the six months ended July 1, 2000, compared to the six months ended July 3, 1999. This increase was due to an increase in demand across all business segments and improved manufacturing productivity in the United States operations. Also, net sales in the six months ended July 3, 1999, were adversely affected by reduced production output in the United States operations related to problems with a new manufacturing system implementation.

Gross profit increased \$3.8 million, or 51.5%, to \$11.3 million for the six months ended July 1, 2000, compared to the six months ended July 3, 1999. Gross profit as a percentage of net sales increased to 26.9% compared to 21.7% for the first six months of 1999. This percentage increase

was due to substantially higher total net sales and an unusually low gross profit percentage in the six months ended July 3, 1999, related to problems implementing a new manufacturing system in the United States operations. Also,

in the six months ended July 1, 2000, prime manufacturing costs in the United States operations were lower as a percentage of net sales than the six months ended July 3, 1999, primarily due to reduced costs of purchased parts and improved productivity. Manufacturing overhead expenses in the United States increased in the six months ended July 1, 2000, over the same period last year due mainly due to higher depreciation expense.

Selling, engineering and administrative expenses increased 17.0%, or \$1.0 million, to \$7.2 million in the six months ended July 1, 2000, compared to \$6.2 million in the six months ended July 3, 1999. This increase was due primarily to increased spending levels for product catalogues and for support and enhancements to new software systems installed last year in the United States and the United Kingdom operations.

Interest expense was \$0.6 million for the six months ended July 1, 2000, compared to \$0.4 million for the six months ended July 3, 1999. This increase was due to an increase in total debt of \$1.0 million, and increased interest rates on both lines of credit in the United States, which vary in relation to the United States prime rate.

The provision for income taxes for the six months ended July 1, 2000, was 33.3% of pretax income, compared to 31.2% of pretax income for the six months ended July 3, 1999. The change in rate was primarily due to the mix in pretax income in the operating business segments. Tax savings were realized in the United States from the Sun Hydraulics Foreign Sales Corporation. The Company had previously recorded its provision for income taxes believing an income tax benefit had been obtained for the Korean operation; the tax benefit request was recently denied by the Korean government. Although, the Company plans to resubmit an application for this benefit, management is unsure of the outcome. A retroactive, immaterial adjustment has been recorded for the six months ended July 1, 2000 to increase the provision for income taxes.

Net income for the six months ended July 1, 2000, was \$2.2 million compared to \$0.5 million for the six months ended July 3, 1999.

## 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.

Cash flow from operations for the six months ended July 1, 2000, increased \$3.3 million to \$5.3 million compared to \$2.0 million for the six months ended July 3, 1999. This increase was due to higher net income and improved utilization of working capital. Capital expenditures, consisting primarily of purchases of machinery and equipment, were \$3.2 million for the six months ended July 1, 2000, compared to \$3.1 million for the six months ended July 3, 1999. On March 15, 2000, the Company invested an additional \$0.1 million in its 50/50 joint venture agreement in China. (Also, see Note 3 to the Consolidated Financial Statements.)

In 1996, the Company was awarded a grant of \$0.4 million by the German government, which helped to offset the cost of the German facility. The grant required that the German operation employ 26 people by June 30, 1998. Although, this deadline was extended several times, it has been determined that \$0.1 million must be repaid during the third quarter because the hiring criteria was not met. Since this item was recorded as a deferred grant, the repayment will affect only cash; it will not affect net income except with respect to the interest component, which is immaterial in amount.

The Company has four revolving lines of credit: two in the United States, one in England, and one in Germany. None of these arrangements contain pre-payment penalties. For an analysis of Company debt, see Note 4 to the Consolidated Financial Statements.

The Company has notes payable to five former shareholders that bear interest at a weighted rate of 15% and have terms expiring in one to four years. These notes were issued by the Company in 1989 and 1990, in connection with the repurchase of shares of common stock from former shareholders and do not allow for prepayment by the Company. At July 1, 2000, \$0.3 million was outstanding under these notes.

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 June 30, 2000, which was paid on July 15, 2000.

## 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 July 1, 2000, and July 3, 1999. There can be no assurance, however, that the Company's business will not be affected by inflation in the future.

## 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 January 1, 2000, and "Management's

Discussion and Analysis of Financial Conditions and Results of Operations" in this Form 10-Q for the quarter ended July 1, 2000. 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.

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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.

The Annual Meeting of Shareholders of the Company was held on May 13, 2000. At the meeting, the following actions were taken by the shareholders:

John S. Kahler and Robert E. Koski were reelected as Directors to serve until the Annual Meeting in 2003; Allen J. Carlson was elected as a Director to serve until the Annual Meeting in 2003; Christine L. Koski was elected as a Director to serve until the Annual Meeting in 2002; until their respective successors are elected and qualified or until their earlier resignation, removal from office or death. The votes cast for and against each were as follows:

	For	Withheld
Allen J. Carlson	3,919,281	4,050
John S. Kahler	3,919,281	4,050
Christine L. Koski	3,919,281	4,050
Robert E. Koski	3,918,881	4,450

The appointment of PricewaterhouseCoopers, LLP, as the Company's independent certified public accountants for the year 2000 was ratified and approved. The voting on the proposal was as follows:

FOR	3,922,629
AGAINST	702

Item 5. Other Information.

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

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EXHIBIT  
NUMBER

EXHIBIT DESCRIPTION

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).

3.2 Amended and Restated Bylaws of the Company (previously filed as Exhibit 3.2 in the Pre-Effective Amendment No. 4 to the Company's

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\$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 (pound)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 (pound)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).

4.20 Amendment to Recommended Offer by Sun Hydraulics Corporation to acquire the whole of the issued share capital of Sun Hydraulik Holdings Limited, dated December 17, 1996 (previously filed as Exhibit 2.1 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).

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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- 4.28 Security Agreement, dated July 23, 1999, between the Company and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.28 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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- 10.6+ Sun Hydraulics Corporation Employee Stock Award Program (previously filed as Exhibit 4 to the Company's registration statement on Form S-8 filed on July 20, 1999, and incorporated herein by reference).
- 27.1 Financial Data Schedule for period ended July 1, 2000 (for SEC purposes only).

+ Executive management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K.

Report on Form 8-K (dated December 8, 1999) filed January 12, 2000, announcing the election of Allen J. Carlson as Vice President of the Company.

Report on Form 8-K (dated March 7, 2000) filed March 10, 2000, announcing year-end 1999 and fourth quarter financial results.

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Report on Form 8-K (dated April 28, 2000) filed May 4, 2000, announcing anticipated management changes and 1st quarter financial results

Report on Form 8-K (dated May 12, 2000) filed May 18, 2000, announcing management changes and 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 August 7, 2000.

### SUN HYDRAULICS CORPORATION

By: /s/ Richard J. Dobbyn

-----  
Richard J. Dobbyn  
Chief Financial Officer (Principal  
Financial and Accounting Officer)

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## EXHIBIT INDEX

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED BALANCE SHEETS AND CONSOLIDATED STATEMENTS OF THE REGISTRANT AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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